The Canadian Chartered Accountant

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THE TAX REVIEW

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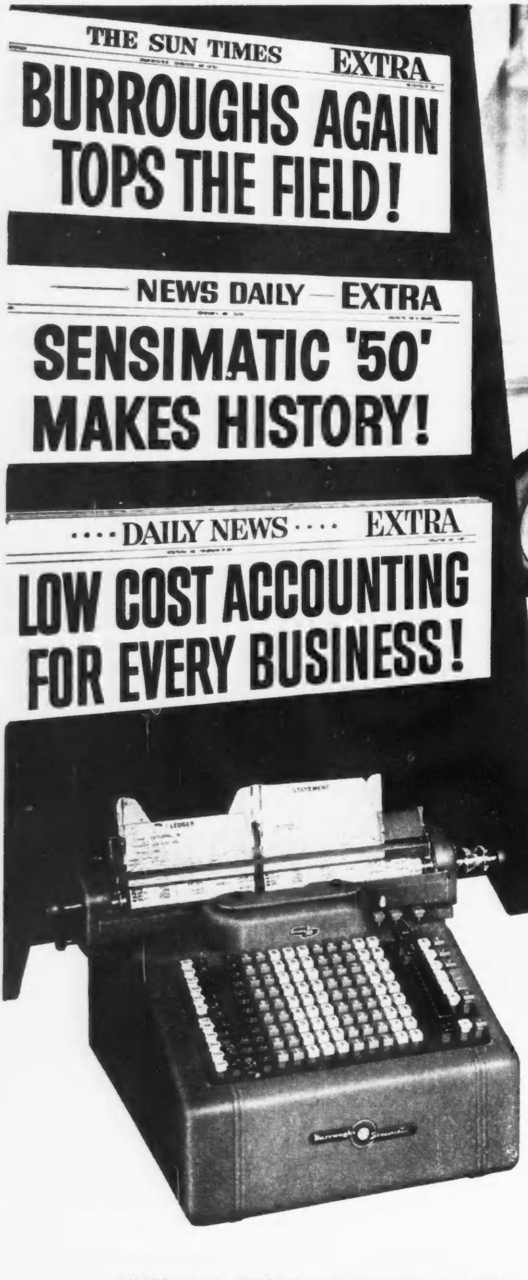

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SWEETNESS and LIGHT

By Jay Vee

An Appeal

LAST month's column dealt in facetious vein with the culinary and household skills of the menfolk of our acquaintance, but today how glad we are for the help they have given us lately.

By a sudden turn of events we now find ourselves chief cook and bottle-washer for the family, practical nurse for the patient, water-changer for six vases of flowers, and in a modified way still assistant editor of this journal.

Like most people living at home we had always maintained we could drum up a respectable meal now and again. As a matter of fact we boasted a selection of four menus and tried them out once a year at vacation time. But after six weeks or 126 meals we were completely out of ideas. Breakfast of course is pretty standard and presents no problem. Nor is dinner of the meat, potatoes, and vegetable variety too difficult. But lunch! It was a case of soup, soup everywhere and no time to learn anything new.

It was at this dark brothy moment that friend Paul Dandeneau came to the rescue with his recipe for porcupine meatballs. You simply take some minced beef and some rice, flavour with salt and pepper, and roll into balls. Then pour a can of tomato soup into the pressure cooker, drop in the meatballs, and let them simmer for half an hour. How do they taste? Delicious.

This week the C.I.C.A.'s public relations specialist, Renny Englebert, told us about his Cottage Cheese Delight. Buy a carton of cottage cheese from a groceteria, put it on the plate and pour a

Sweetness and Light

drained can of peaches over it. That one really caught the fancy of the lady in the bed jacket upstairs.

Why we elaborate on these is because we are appealing to our readers to tell us of any simple dishes they have been able to concoct. The only requirement is that it must not use raw vegetables or fruit — most salads are *verboten* for that reason. Something that would not require more than 10 minutes to prepare before cooking would be especially acceptable because of the packed time schedule. But if ever you have to get a Saturday lunch for your youngsters while your wife goes downtown shopping, or if you live with a brother and sister-in-law who might go away an occasional week-end, won't you please let us know any tasty little numbers you have learned about — the reference is only to food, of course!

The Perfect Squelch

A NEIGHBOUR'S Aunt Mary is a widow nearing 70 but she has managed to keep a trim figure and a slim ankle. And so it is not too amazing that as she walked up her street about 10 p.m. the other night a youngish man began to follow her. From a few yards behind he first asked the time-honoured "Haven't I seen you somewhere before?". Then advancing a little more quickly he suggested that she might like to join him in a couple of Singapore Slings at the nearest cocktail bar. (Aunt Mary was only slightly alarmed but also, as she admitted later, somewhat elated that she hadn't yet lost her grip, as they say in feminine circles.)

Still, enough was enough. She walked on quietly to the next street light with the man following persistently. There she stopped and when he came along, turned a well-lined face toward him and said, "Sonny, don't you think you had better go home? Your mother may be wanting you!"

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COMMENT AND OPINION

Two Little Words

SINCE the new Ontario Corporations Act came into force on April 30 of this year every Ontario company must disclose in its financial statements the "total remuneration of directors as such from the company [and subsidiaries], including all salaries, bonuses, fees, contributions to pension funds and other emoluments". At first reading this seems to be a most laudable requirement and certainly an innocuous one. Nevertheless it has already given rise to confusion and doubt and there is good reason for supposing that, in some cases at least, strict compliance with its terms will actually prove misleading to shareholders. The difficulty arises because of those two little words "as such" following the word "directors" in the above phrase, which is found in paragraph (1) of section 84 (1) and in paragraph 10 of section 87(2) of the Ontario Corporations Act.

The confusion comes about in this way. Does the obligation to disclose "remuneration of directors as such" require disclosure of the amount which the directors receive for their services as directors only, or does it require disclosure of the amount received by the directors for their services as directors, officers and employees, and perhaps for other services as well? One has only to read the words of the statute to realize that the ambiguity is a very real one. Indeed, it is understood, opinions have been obtained from counsel in support of each of the alternative constructions, but the weight of opinion so far is that disclosure is required of the remuneration of directors as directors alone. Moreover this last happens also to be the view of no less a person than Mr A. Kelso Roberts, Q.C., M.P.P., who was chairman of the select committee of the Ontario Legislature which reviewed the legislation before it was passed into law. Referring to the enactment in question, Mr Roberts recently wrote that it means that a director who may also be a general manager will not under that provision have his remuneration as general manager included.[1]

While the provision in question stems from a recommendation made to the Ontario Legislature by a Committee of the Ontario Institute of Chartered Accountants, no blame attaches to the Institute for the ambiguity, since the two words which have given rise to the confusion did not appear in the recommendation of the Institute. In that respect the Ontario Institute's recommendation followed that of the Companies Act Committee of the C.I.C.A. and is in general accord with the corresponding provision of the British Companies Act of 1948.

If the construction which has the sup-

[1] *The Secretary*, Sept. 1954, p. 410

port of Mr Roberts as well as of many other members of the legal profession is the correct one in law, it is, we think, the wrong one from the point of view of shareholders. The whole object of the provision for disclosure of directors' remuneration from a company is to protect the shareholders through publicity. If disclosure is required of nothing more than directors' fees, and directors remain free to award themselves remuneration for services in other capacities, the amount of which need not be separately disclosed, the whole object of the provision becomes nugatory. Indeed it can actually prove misleading, since the reader of a financial statement which shows an amount described as "directors' remuneration" may well suppose that the amount shown is the entire amount received by the directors from the company when in fact it may not include the remuneration received by them as officers and employees. This is not a situation to the liking of those who feel that shareholders are entitled to know the full amount the directors have voted themselves out of the funds of the company [and subsidiaries].

It is not surprising therefore that the Ontario Institute has reconvened its Companies Act Committee to deal with this situation. Their report will be awaited not only by members of the Ontario Institute but by the entire profession.

In the meantime, auditors of Ontario companies must examine and report on their financial statements, and it will be remembered that the Act obliges them specifically to report to the shareholders if the company's financial statement is not in accordance with the requirements of the Act. Where a company is prepared to show the total remuneration of directors, stating separately the amount paid as directors' fees, no question will arise as to compliance. The information furnished will meet either possible alternative. If, however, the directors of the company adopt the view that the Act requires only that the remuneration paid directors in their capacity as directors need be disclosed, the auditor can properly ask for an opinion from the company's solicitor to the effect that such disclosure is adequate. In cases where only this information is shown, the statements themselves should make clear what is being shown by describing the amount in such terms as "directors' fees" or "remuneration of directors as such (excluding remuneration for services as officers and employees)".

Such a situation is not a happy one but we can hope it will only be temporary. The Companies Act enacted by the Province of Ontario is far in advance of any other Canadian legislation in this field. Generally speaking, the accounting sections are clear and it is unnecessary to obtain a legal opinion to know whether a company is complying with them. It is to be hoped that this one small blemish will soon be removed by amending legislation spelling out exactly what is intended.

Some of the Companies Acts of the nine other Provinces as well as that of the Dominion are soon to be revised, and Ontario's experience on this question should prove illuminating and helpful.

"Market Value" in Valuing Inventory

ON September 9 judgment was pronounced in the Exchequer Court of Canada by Mr Justice Cameron in a tax appeal concerned solely with the determination of "market value" in valuing damaged or obsolete stock. The stock in question consisted mostly of ladies' fur coats, the value of which had declined below cost through shop damage, change in fashion, and a reduction in excise taxes, and the question at issue was the

figure at which they should be carried in the taxpayer's year-end accounts for 1946 (which was an excess profits tax year). On this question the taxpayer and the Revenue Minister differed, the latter's valuation being some $27,000 higher than the taxpayer's, and Mr Justice Cameron has resolved the dispute by fixing the valuation $11,600 higher than the taxpayer's, but $15,400 lower than the Minister's. In the Income Tax Appeal Board a valuation some $22,600 higher than the taxpayer's had been placed on the goods by Mr W. S. Fisher, so that in result the taxpayer fared not too badly in the Exchequer Court, the more so since the Crown, though winning a partial victory, will have to pay the costs of the proceedings in the Exchequer Court.

The case is naturally of interest to accountants though the facts are so exceptional that doubt may exist whether the judgment is of great significance as a precedent for future cases. The determination of "market" value in applying the formula "lower of cost or market" to the valuation of inventory is, said Mr Justice Cameron, entirely a question of fact. Citing the evidence of a chartered accountant he indicated that in respect of damaged or obsolete goods "market value" means primarily replacement cost, i.e. the cost at which similar goods in customary quantities can be purchased less a deduction for depreciation due to shop wear and the like, or, if replacement cost is not ascertainable, the amount which it is estimated will be realized on the sale of the goods less the costs of sale and the taxpayer's usual gross profit. But, in ascertaining the realization value of merchandise at the end of a taxation year, added His Lordship, it is wrong to take into account reductions in sale prices which the merchant will possibly or even probably have to make during the next year or later. This, he said, would be to set up in effect an inventory reserve.

On the evidence before Mr Justice Cameron it proved to be impossible to ascertain the replacement value of the merchandise at the close of the taxpayer's 1946 year, and he held that its market value must therefore be fixed at its estimated realizable value less the taxpayer's usual profit. So far so good. But, he proceeded, its estimated realizable value must be determined on the basis of the sale prices which the taxpayer placed on the merchandise during the first month of its 1947 taxation year *without any regard to subsequent price reductions anticipated at that time.* The prices in the first month of 1947 were, he said, "prices which [appellant] hoped to realize and, had the demand been more active in [that month], appellant would have realized them on the whole of the inventory". The demand was not more active, however, and in fact it took appellant several months to sell all of the coats, and during that time the sales prices were several times reduced, as the appellant had anticipated in valuing them in its 1946 closing inventory.

Accountants will have some difficulty in appreciating the reasoning on which the judgment rests, that in endeavouring to ascertain the amount which merchandise on hand will fetch when disposed of in the future one cannot take into account the fact that it will not all be disposed of forthwith or that goods disposed of in the more remote future will fetch less than those disposed of in the immediate future, and that to take those considerations into account is somehow to set up a reserve against future contingencies rather than to place a present value on existing stocks.

The Operating Budget

By J. M. Thompson, C.A.

The budget must not be a tool of the accounting department but a program of operations supported by all departments

THE year 1953 saw the end of an era just as surely as 1929 rang down the curtain for the period of growth and expansion which followed the first World War and as the commencement of hostilities in 1939 brought to a conclusion those unhappy depression years. I do not believe for one moment that we are entering another depression, but the period when the only restriction on achieving new sales records was our ability to produce without regard for costs has certainly come to an end, and for some of us it had already happened before the end of 1953.

Highly Competitive Market

Since 1940, industrial production has increased 124%, due to the expansion of established industries and a large influx of new competing enterprises attracted to Canada by the remarkable growth that has taken place during these years. In addition, severe foreign competition is being felt by practically all manufacturers. Only modest tariff protection is in effect, without reasonable safeguards against dumping. With our currency freely convertible and at a premium, and no other form of trade restrictions, the Canadian market is the most readily accessible of any industrial nation in the world today.

Since 1939, labour costs have increased proportionately higher than those of any other major industrial nation. For example, before the war there was a traditional wage differential of approximately 25% to 35% between the United States and Canada. Today, this differential would not exceed 10% to 15% and, in many instances, individual companies are paying equivalent rates. Wage rates in European countries have risen only moderately and would not compare in anything like the same degree with the rise that has taken place in Canada and the United States.

Intensive domestic competition, together with low-cost foreign competition, is forcing prices down to uneconomical levels, while, at the same time, production costs have risen.

One Company's Approach

In facing these competitive problems, we at Westinghouse are intensively re-examining our approach to budgets to see if through this mechanism we can further improve our operating efficiency. I am convinced we can, and for this reason, in discussing operating budgets,

A paper read at the 1954 annual conference of the C.I.C.A., Winnipeg, August 25

I would prefer to talk about our own experience with them and our plans for improving them, rather than deal with the subject in broad general terms. The test of theories lies in their application, and I believe the experience of Westinghouse with budgets will bring out their basic features — both good and bad.

To assist you in following my remarks, I would like to mention a little about my company. Westinghouse is one of the larger manufacturing companies in Canada, with an annual volume in excess of $100,000,000. It makes a complete line of electrical equipment, ranging from the largest waterwheel generators produced anywhere in the world to miniature vacuum-packed tubes for electronics which are no larger than your small finger, as well as air brakes for railroad equipment. The bulk of these products is manufactured in three plants in the city of Hamilton, where we employ some 10,000 people.

The company is divided into ten separate and distinct manufacturing divisions, each with its own sales, engineering, and manufacturing departments. It also operates a supply business which distributes a complete line of electrical contractors' supplies through a subsidiary, Canadian Westinghouse Supply Company Limited.

About the only thing common to the products which these various divisions manufacture is electricity, and even this is not true of air brakes. Production techniques and manufacturing facilities required for each of these lines are entirely different. In effect, we are a number of separate and distinct businesses, not too closely related to one another, either in manufacturing methods or in channels of distribution.

Because of the diversified nature of our business and its many ramifications, there is no one solution to our many problems. While we have common corporate policies for all divisions, we are forced to adopt special methods and procedures to meet the individual requirements of each division. This is particularly true of the problems which arise in connection with distribution.

Introduction of Budgetary Control

To coordinate and direct this diversified business and to enable the management of the company to control its many activities, it has been necessary to develop a system of budgetary control. However, steps along this line were not taken until some ten years ago, when because of the tremendous growth which was taking place in our industry — as well as in our company — it became essential to have a mechanism through which control could be exercised and future actions intelligently planned.

Our introduction of budgets to the company was, in reality, nothing more than an attempt to forecast our business for the succeeding year. The responsibility for the preparation of the budget was assigned to the accounting department, and we tackled the job in a typical accounting way.

We prepared a series of forms on which operating divisions were requested to supply us with particulars of their anticipated bookings, shipments, costs, etc. In most instances, we had to be content with obtaining forecasts of bookings and shipments, and from our own accounting knowledge to supply cost and expense data and estimated profits. The budgets as we prepared them were fairly accurate in forecasting actual results because at that time our principal problem was production, not sales. When, in our opinion, the shipping estimates appeared too high, we did not hesitate to exercise our well-known prerogative of being conservative and reduce these to what we felt was a realistic figure.

None of our operating managers as-

sumed any personal responsibility for these budgets. Rather, they were treated as just so much interesting information and the management accepted them as a probable indication of what the succeeding year's business might be.

Unfortunate Reaction

As we progressed in the use of the budgets, explanations were required of the operating managers for variations, especially in regard to costs and expenses. This did not seem an unreasonable request, since the budgets had been built up on a sound historical basis after discussion with the operating people involved, and provided adequate allowances for additional costs to compensate for increased volume, as well as higher wage and material costs we were required to pay at that time. Expense forecasts — which were excessive — were cut back to more reasonable proportions.

Whether or not the request for explanations of variances was reasonable, it stirred up amongst all operating people a deep resentment towards the budgets — and, of course, a torrent of explanations as to why they were unrealistic. I cannot stress too much how deep this hostility was, and in time it became a habit to blame practically all failures of performance on the budget system. If it was something that should have been done but wasn't, then it was because someone was restricted by the budget.

In effect, it became the "fall guy" for practically everything bad that happened in the organization and, what was even worse, a strong feeling developed that through the budget the accounting department was running the company's business.

During this same period, another important and significant weakness in our organization became apparent. Our company had been growing at a very rapid pace, and we had not been moving fast enough with necessary changes to our basic organization structure to match its growth. Responsibility for many functions was not clearly or definitely assigned, and too often we were unable to place direct responsibility for operating results and expenditures on specific individuals. In other words, we were suffering from "buck passing" insofar as our internal administration was concerned.

Responsibility for Budgets

To correct this condition, we analyzed our organization structure and made such changes to it as were deemed necessary to bring about clear lines of authority over all phases of its activities and to remove any ambiguities and inconsistencies in work assignments.

This was the essential action which we had to take preparatory to changing our approach to budgets. Having clearly defined our management functions, we placed complete responsibility on all management groups for the preparation of their budgets. The budget was no longer a tool of the accounting department to be used as a means of exerting pressure on operating people to do more with less. Rather, it became a plan or a program of operations towards which all employees made their individual contributions.

If the final results as shown by it were not satisfactory, everyone understood why he was asked to reconsider them. If sales volume was too low to give sufficient volume to maintain economical production, then new plans to increase sales were made. If indicated gross profit margins were inadequate, methods were planned to reduce manufacturing costs. There is no limit to the reasons which can be advanced for spending more money. Individuals clearly understood why limits had to be placed on expenditures when they knew that their

division was in trouble and simply could not afford them, no matter how worthy the argument justifying them might be.

Place of Accounting Department

Under this concept, you need not conclude that the role of the accounting department became passive and did not materially assist in the preparation of the budgets. On the contrary, I think its contribution towards their preparation increased, but with the important difference that there was a proper understanding by the operating people of the function the accountants were performing.

It was the responsibility of the accounting department to be of every assistance to the operating people and to supply them with analyses of many kinds and details and procedures to simplify their preparation as much as possible. In working with the operating people, its advice was sought and well-received, particularly in the areas having to do with trends and ratios and obtaining factual information in respect to them.

We developed a comparatively simple method of reporting results and making budget comparisons with them. Wherever possible, we operate with standard costs, although in many parts of our operations we are obliged to use job costs because of the nature of the equipment being produced.

For some time, we had kept our budgets of expenses in factory departments on a fixed budget basis, but have recently changed this to a flexible budget system. In addition to this, we have developed a great deal of statistical data, supplementary to our accounting statements, particularly on payrolls and factory expenses stated in terms of man-hour costs.

Acceptance of the Budget

To summarize, we now have complete support by top management of the principle of budgeting — and acceptance of it by all operating people. It is understood that this planning or programming mechanism which is essential for good management is not a tool used by the financial or accounting section of the company to bring undue or unjustified pressure on the organization to cut down costs of doing business.

Mr J. M. Thompson, C.A. began his career with Clarkson, Gordon, Dilworth Guilfoyle & Nash in 1929 and was admitted to the Ontario Institute in 1933. In 1940 he joined Canadian Westinghouse Co. as assistant comptroller and in 1945 was made comptroller. Since 1950 he has also been vice-president of the firm. For the past 10 years he has served as budget director of the Hamilton Community Chest.

The accountants are accepted as a staff group at all times willing to pitch in and assist all levels of management in developing plans as they are expressed through the budget and to keep them informed through monthly reports of the progress that is being made in accomplishing these forecasts.

Our advertising department has adopted a slogan for our appliance, television, and radio products which reads "Take a new look at Westinghouse". While our actions are not inspired by this slogan, it is what we are doing today in connection with our budget procedures as well.

In fact, we are taking a new look at everything we do today to make sure that we are getting full value for the money we spend — for that is exactly what our customers are doing in making their decisions as to whether or not they will "Buy Westinghouse". Each dollar we spend must add value to the products we manufacture. I am positive that through proper budgeting we can best assure ourselves that this is being done and that

unnecessary dollars, which do not contribute to this, are not being spent.

Some Shortcomings

Having taken a "new look" at our budgeting — considered as planning — we have concluded that it has some very serious shortcomings. For instance:

(a) It lacks specific objectives. Promised performance has been judged on the basis of increased volume with a commensurate increase in profits. However, if profit margins are declining, explanations, such as lower prices due to competition, increased costs because of general wage increases, or other equally justifiable reasons, have been accepted. Definite yardsticks of performance have not been set by which to judge operating results, nor has a clear understanding been reached with operating managers that they must achieve an indicated level of performance in spite of adverse conditions.

(b) While we recognize the budget as a plan or program of promised performance, we have not supplied our division managers with a clear-cut guide to follow in formulating and developing such plans, both on a short-term and a long-term basis. Specific plans of action which are evolved are, in too many cases, the product of exigencies to meet particular situations, rather than carefully prepared plans to achieve specific, well-defined objectives. The quality of the planning varies in direct proportion with the aptitudes and abilities of individual managers, and seldom do they set out how, when, and by whom these plans are to be put into effect.

(c) A proper training program does not exist which will assure the development of personnel that would be available with adequate training to carry out a definite planning program. Current training programs only provide for the development of technical or other specialty skills required in the electrical industry.

Planning

Recognizing these shortcomings, we have recently assigned the responsibility for developing techniques and procedures to overcome them to a small group of our younger executives, and we expect them to make their recommendations to us in the course of the next month or so. Fortunately, the Westinghouse Electric Corporation of the United States, with whom we are associated, has just recently issued to all its operating divisions a Planning Guide which we hope we can use in formulating this program.

The purpose of this Planning Guide is to assist the corporation in further developing its own planning program, both on a short-term and a long-term basis, and to assure that the many diversified units of the company are properly coordinated and that all are working towards a common objective. This Planning Guide is designed to suit the requirements of a company doing an annual volume of business of one and one-half billion dollars and, of necessity, is prepared in such a detailed and comprehensive manner that it would not be suitable for application in a much smaller company such as ours. However, the basic principles are established, and it is our hope that we can successfully adapt them to meet our requirements.

Our own views are only now being crystallized and put into practice. However, the principles are so clearly established that I believe I can outline our thinking.

The Basic Objective

Our Planning Guide sets as its basic

objective the obtaining of an adequate return-on-assets as its prime yardstick for measuring the performance of each of its divisions and of the company as a whole.

I am afraid that the principle of obtaining an adequate return on capital has been overlooked by many of us. The emphasis has been on the margin of profit and volume of sales. This is only natural, since in our accounting statements it is customary for us to show operating ratios as a percentage of sales; few of us extend these ratios to include asset or net worth return.

Furthermore, in our annual statements we stress, both in the text and by graphs, the relationship of profits to sales in an effort to educate the public to the fact that corporation profits are reasonable and that for each dollar received only a small percentage is retained as profits. Surveys which I have seen have shown that the general public believes that corporation profits are anywhere from 15% to 50% of the sales dollar and that increased costs, particularly for labour, could easily be paid without materially affecting them.

In our preoccupation with accounting and with eradicating these misconceptions from the public mind, we have lost sight of the primary yardstick by which success or failure is judged — the return on invested capital to the shareholders. The profit percentage on the sales dollar is of only academic interest as compared to this basic yardstick of performance.

You will note that I have stated that the objective of Westinghouse is an adequate return-on-assets, and not on the net worth of the company. It is realized that investors look for a return upon the net investment in the company, but for purposes of operating management it is felt it must be concerned with the effectiveness with which it manages all capital under its direction.

Yardstick of Good Management

For this purpose the best yardstick is a return on total assets used in a specific division or section of the company's business. Included in total assets are cash, accounts receivable, inventories, fixed assets at original values, and other miscellaneous items. The original value of fixed assets is used as a means of injecting a rough adjustment factor to provide some equalization between divisions of facility values — old plants built at relatively low cost as compared with new plants built at high cost. This is on a rough assumption that the relative inefficiency of the older plant is compensated adequately by its relatively lower gross value without deduction of accrued depreciation.

The percentage return-on-assets which has been set for all divisions and for the company as a whole is 20% before taxation. Great emphasis is laid on the fact that those products which fail to yield this return-on-assets hinder the achievement by the company in attaining its overall goal.

This basis which has been adopted is one which is considered to be reasonable of attainment by its operating managers. Needless to say, I am not suggesting that this formula be used by other organizations, but only that the principle of setting a specific objective of performance based upon the use of capital be recognized.

To achieve the best return-on-asset performance requires the maximum utilization of assets to obtain the greatest volume of sales at the highest possible profit margins. By introducing the asset turnover factor to the usual profit margin ratio, the attention of management is focused on the necessity of capital conservation and utilization. It is extremely important that this simple relationship be made abundantly clear to all operating management.

This can be done by simple illustrations, such as showing that a 5% profit margin yields a 20% return-on-assets if the sales volume is four times that of the asset value, whereas a 20% profit margin will only yield a 5% return-on-assets if the sales volume is only one-quarter of the asset value.

The analysis of profit performance against this standard relationship between profit margin and asset turnover does not provide a guide as to the turnover of fixed and current investment separately or of individual asset accounts such as receivables and inventories. The problem of low asset turnover must be solved by reference to each of these types of assets to assure that they are turned at a maximum practical rate, although no general standards can be established for application to all products manufactured by the company. Low inventory turnover is often the reason for an unsatisfactory return-on-asset ratio.

Long-Term Objectives

To accomplish the profit objective of the company, specific and definite long and short-term plans must be formulated for actual accomplishment of the desired results. Long-term objectives should be established for each product or product line in terms of:

(a) share of market;
(b) sales volume;
(c) costs;
(d) operating profits;

plus:

(1) required assets;
(2) turnover;
(3) return-on-assets.

For instance, these long-term objectives are set out by Westinghouse Corporation for a five-year period and are re-established annually for the fifth year ahead. Thus, objectives established in 1954 are for the year 1959.

Having determined upon the long-term objectives, a support program is prepared to develop a series of specific projects for execution which, in their aggregate, will reasonably assure that the long-term objectives are attainable. This term "supporting program" means the specifically scheduled plans of action designed to improve the performance of the business from its present level of performance to that stated in the long-term objectives.

Such programs identify the problems which must be overcome and specify what action is required, who is responsible for the action, and when it will be initiated. In measuring the effectiveness of any of these programs in closing the gap between present performance and the company's goal, the effect of the sales, profit margins, and asset relationship is constantly analyzed to see that they are achieving their objective.

Supporting Programs

The supporting programs will resolve themselves into:

(a) Sales increasing programs;
(b) Cost decreasing programs;
(c) Asset minimizing programs.

The sales increasing programs will cover the usual factors associated with increasing sales such as adding new lines, product changes, improvement of distribution methods, etc., and the cost decreasing program will include plans for reducing both direct and indirect costs.

The asset minimizing program will provide for a review of product lines to eliminate low-volume items, improvement in the manufacturing cycle to minimize work-in-progress inventories, inventory control methods to reduce stocks of parts and finished products, and development of programs to assure optimum utilization of fixed assets.

Each one of these programs must be specifically docketed for follow-up and

execution — and must indicate the results expected from it in the succeeding year for incorporation into the budgets. This formalized procedure is designed to overcome one of the greatest weaknesses in budgets, where the contemplated plans of action so often end up as only good intentions and are never put into effect.

Additional Facilities

Closely allied with the supporting program is the authorization for facilities expenditures, since, in many instances, the execution of such programs requires plant facilities. In submitting facilities expenditures for approval, specific forms are provided which require the filling out of all pertinent data in respect to them. They are classified into four categories: —

1. Those intended to provide greater output or to manufacture new products.
2. Those in support of product redesign or broadening of line primarily for the purpose of improving saleability.
3. Those intended to reduce costs or expenses.
4. Those designated as necessities and which cannot be measured by financial considerations.

To institute this plan of establishing long and short term objectives and developing supporting programs for them, a Planning Board, charged with the responsibility to see that it is carried out, is set up in each division. Personnel of these Boards is left to the discretion of individual managers, but would normally include representatives of sales, engineering, manufacturing, and accounting.

The Boards of the divisions submit their planning programs to a main Planning Board of the company for approval. Definite time schedules are established when each step associated with the planning program must be in the hands of the main planning Board.

Training of Personnel

The programs and plans designed to chart a company's future progress and growth would be incomplete if they did not provide for the proper training and development of people to assure their fulfilment. Westinghouse has a wide variety of such training programs providing both technical and "on-the-job" instruction, as well as a management development program to assure that it will have a continuous flow of properly trained employees and executives capable of assuming the responsibilities which will be associated with its growth and development.

It has also recognized the importance of creating incentives for individuals to see that programs developed under the Planning Guide are actually implemented. For this reason, their incentive compensation plan is definitely related to the extent by which divisions succeed in closing the gap between present performance and the corporation's objective of 20% return-on-assets and put into successful operation specific plans for accomplishing this.

This planning program of the Westinghouse Corporation which I have briefly outlined, and which we intend to adopt in a modified degree, may seem to be very far removed from the operating budget. However, my conclusion is that it is not, and that in our approach to the operating budget it is essential to consider it in new terms and in its real perspective as a plan of action.

This is a long step from our early concepts of budgeting, which were introduced as a measure of exercising control. The measure of control exercised through budgets is still present, but to it has been added a broader and greater utilization of its values by encompassing

within it an expression of the company's goals or objectives and a formalized definite plan of action, in the field of facilities, manpower, marketing techniques, and finance by which these will be accomplished.

This is our "new look" at budgets. They are not a compilation of so many figures but the blueprint of promised performance, in the achievement of which everyone associated with management — foremen, superintendents, sales groups, managers, general management — must play his part. We are confident that our company can improve its performance under this broad concept of budgets.

Preparation of the Annual Reports to Shareholders

By Louis Driscoll, C.A.

The modern report is a decided contrast to that of four or five decades ago

THE published reports and accounts of corporations tend to be both more interesting and informative than they were a few years ago. The fact is of great advantage to the individual shareholder, but the improvement, on the whole, has not been as a result of pressure applied directly by him. It has rather been through a combination of different influences working on his behalf and reinforcing the limited legal reporting requirements which were mandatory under legislation dealing with incorporation. Management has come to recognize both an obligation and an advantage in the dissemination of information. The professional accountant has played an important although not an exclusive part in bringing about the change and has done so in several ways. From the outside he has exercised a direct influence in his capacity as auditor for the shareholders and also in his capacity as an adviser to governments and such regulating bodies as stock exchanges. A further and important influence has been developing from the inside during recent years as the professional accountant has come to enter to an increasing extent into corporate management and to occupy a greater number of positions of responsibility in it. In the exercise of managerial responsibilities he has continued to be governed by the precepts absorbed during his professional training, and in these positions he has had a greater opportunity than previously to get his precepts accepted by management.

A Fundamental Precept

One precept, fundamental to the professional accountant, is that a corporation should make full and proper disclosure of its financial picture to its owners, the shareholders. I believe that the large and growing body of professional accountants who are now within the corporate field have been of great help to practising professional accountants in developing the shareholders' annual report to the higher standards of disclosure reached within recent years.

The practices and accounting treatments followed by corporations south of our border have, in recent years, had a great influence on the financial customs adopted in Canada. This is reflected in a very marked way in the general appearance and format of annual reports now being issued by a large number of our

A paper read to the 1954 annual conference of the C.I.C.A., Winnipeg, August 25

Canadian corporations. The U.S. Securities Act of 1933 and Securities Exchange Act of 1934 and the numerous regulations which have been issued under them have grown to make corporate managements recognize more fully the inherent right of the present shareholder and the prospective investor to full and accurate information.

In no other country in the Western world do holders of equities and capital obligations of large public companies have such full disclosure of complete and accurate information, relating both to historical as well as current finances and operations, as they have in the United States and in Canada.

Apart from the influences exerted by practising and non-practising professional accountants, other influences external to the corporation have brought about the reformation in annual reports to shareholders at a pace quicker than might have otherwise been the case.

One of these factors can be found in that group which comprise financial services, financial papers, and periodicals. In publicizing, analyzing, and interpreting all pieces of information, irrespective of source, these have provided an impetus to corporations to disclose their financial status and financial results annually and, in many instances, even quarterly, to the public at large.

Effect of Widespread Stock Ownership

Another factor is that ownership of business in this continent has never been so widespread as it is today. Possibly one of the natural results of this growing widespread ownership, in contrast to the closely held ownership only a relatively few years ago, has been the development of a democratic, in place of an autocratic, attitude on the part of corporate officers toward shareholders and toward the general investing public as well. The former attitude of "tell them nothing" which prevailed to a large extent two decades ago is now almost a thing of the past. In fact in some extreme cases today the attempt seems to be to satisfy all the varied interests of the general audience of readers at the one time, with the result that such reports are so formidable or bewildering that the interest of the shareholder, the most important member of the audience, is quickly dissipated after leafing over a page or two. It may be that this extreme type of report, in telling too much unwittingly, accomplishes the same purpose as did the "tell them nothing" attitude of a few years ago.

One giant company in the U.S. is reported as having some 1,300,000 shareholders. Ownership of one large company in Eastern Canada is in the hands of 116,000 individuals and, as another example, very close to home, 55,000 people share in the ownership of one company whose head office is located in Winnipeg. These random examples well support the statement regarding widespread ownership; they also serve to bring to mind that the activities of such large companies have a vital influence on the general economy in both of these countries. Any large company or company of a class which has a reasonably substantial influence on the nation's economy must accept the fact that it is a "semi-public" institution. A president of a large steel company recognized this some 15 years ago when he stated in a published interview, "The people have a right to know how the people's business is carried on; and the more they know about it, the better it will be for the business. Big business, like human life, cannot thrive properly in the dark." As semi-public institutions they cannot escape the responsibility of providing periodically sufficient factual information to enable the public, and particularly their own shareholders, to make an in-

formed evaluation of the part these companies are playing in the economic life of the nation. Practically every company has such an obligation to some portion of the public at large, and the annual report to shareholders is perhaps the best means by which companies can fulfil such obligation.

Mr Louis Driscoll, C.A. a University of Manitoba graduate, served his time with the firm of Price Waterhouse & Co. and became a member of the Manitoba Institute in 1930. In 1947 he joined United Grain Growers Ltd. as assistant treasurer and became treasurer in 1951. He is on the Board of the Winnipeg Chamber of Commerce.

Annual Report Contests

The annual report contests which have been conducted in recent years have provided wide publicity of trends in the modernization of company reports. Also these various contests have probably, to some degree, created a competitive spirit among many companies which attempt to produce a prize-winning report and thereby gain the acclaim and publicity which results. *The Financial World,* an American investment and business weekly magazine, has just conducted its 14th annual survey. It makes awards for distinguished achievements in annual reporting, having regard for those which are the most modern from the standpoint of content, typography, and format. In commenting on its most recent survey *The Financial World* states that, of the 5,000 reports entered in the contest, over 60% were regarded as inadequate or backward. So there is still a substantial number of corporations which, through indifference or lack of year-end planning, do not meet the standards now adopted by more alert managements.

For the past three years *The Financial Post* has been making awards to Canadian companies whose annual reports are judged the best in their respective fields. *The Accountant,* a magazine published in London and self-described on its masthead as "The Recognized Weekly Organ for Chartered Accountants and Accountancy Throughout the World", has from time to time stressed editorially the need for more informative published accounts. This magazine announced only recently that it would make one or more awards annually to companies for the best form and content of the report and accounts as issued to shareholders. It stated that one of the main factors which would be considered in judging the annual reports would be the adequacy of the information given and the manner of presentation.

As these contests recur year by year and give publicity to the reports examined, by commending praise-worthy features and condemning or criticizing shortcomings, I think they will continue to make a substantial contribution toward raising the standards of many company annual reports which today can be classed as inadequate or backward.

The Modern Report

The modern prize-winning report of today is a decided contrast to the little leaflet of figures issued by corporations in the yesterdays of some four to five decades ago. The average modern report of today runs from 16 to 36 pages and contains graphs, photographs, and charts as well as historical, financial, and other data, financial statements for the year under review, and considerable narrative on non-financial matters. All are set out with a variety of refinements, layouts, and headings, and usually bound in a cover designed to attract attention and create desire of possession.

Where the annual report of yesterday was merely a ritual statement of financial facts directed to the shareholder, it is to-

day commonly treated as one of the chief instruments of communication, not only with shareholders, but with creditors, customers, and employees, and many other elements of the public, such as banks, governments, and investment analysts.

From a recent survey of a comprehensive number of reports it appears that there is a gradual trend toward adopting the eight and one-half inch by eleven inch size, or letter size. The trend toward attractive, and in many cases elaborate, cover design is reflected by the fact that over 55% of those reports were printed in three or four colours. The cover of an annual report should readily identify the company, and the placing of the company's trademark or seal at one definite position on the cover each year is a device which many companies have adopted for this purpose. This allows for variable background treatment year by year of the remaining cover area.

The President's Statement

As we open up the cover of an annual report we have come, in recent years, to expect an essay by the president, giving an account of his stewardship for the year. The more acceptable class of report will have an essay which is not only readable but designed to capture the reader's interest, whether he is a small investor, a customer, an employee, a professional analyst, or an adviser to a financial institution. The type of president's message which consists only of a repetition of figures found in the financial statements contained in the report is of little satisfaction to the average shareholder. Several polls of shareholders have been conducted over the past four or five years, and the results all suggest that the majority of shareholders want more than just financial information about their companies. However, in the result of these polls, recognition is also given to the fact that such additional information should be just supplementary to the real basic purpose of the annual report, which is to inform its owners as to its financial affairs, the results for the year, and its overall financial position as at the end of the year.

What Do Investors Think?

For purposes of this paper it was obviously impracticable to carry out any comprehensive type of poll, but a few owners of diversified investment portfolios were good enough to set out their view on annual reports. Two of the replies received are representative of the remainder. One letter reads:—

> My interest is captured by such sections of a report which tell about prospective plans for the future or research and development of new products and services. In regard to internal matters, such as labour policies, tax policies, trade policies, or historical background, I certainly would not miss them if they were not there. I am interested in both past and current earnings for the sake of comparison and like to see the figures for about five years, together with the book value of shares for the corresponding years. Some companies give the highlights of the report on the first page — this I like.

Another letter states: —

> There are only three things in an annual report which interest me: (a) a quick summary of the highlights of the year, (b) a four or five-year financial summary, showing for each of the years the net income amount and the net income per share, the working capital, investment in plant and annual additions to plant, the per-share book value, and possibly such other items as total income taxes, wages, number of employees, number of shareholders. (If there are a few charts interspersed throughout the report I may pause and glance at them; if they are well designed I will stop and study them.) (c) I always make a point of reading the auditors' certificate with care.

Criteria of a Good Report

In reporting on its most recent survey of Canadian company reports *The Financial Post* set out the features its judges looked for. These judges were representative members of the Canadian Institute of Chartered Accountants, Investment Dealers Association of Canada, and Association of Canadian Advertisers. The list of features looked for by these judges was reported as follows: —

Consolidation of subsidiaries

Information on subsidiaries' position where not consolidated; reasons for not consolidating

A list of all subsidiaries

Two-year comparisons throughout balance sheet and income and surplus accounts

Net sales or gross revenue figures

Sufficient detail in profit and loss account so that shareholder can know at least sales, operating expense, administrative and other expenses

Full notes explaining significant items in balance sheet and profit and loss statement

Source and disposition of funds statement

Table comparing important balance sheet and profit and loss items of past years with present, to put year covered in perspective

Table of highlights, normally early in report

Charts and graphs, as simple as possible to illustrate highlights and the abstruse.

Also, they looked for adequate comment on capital expenditures, change in level of sales and expenses, and future outlook of the company.

Stress on Essentials

Brevity and stress on essentials should be the dominating characteristics of financial statements, just as they should be the dominating characteristics of the narrative part of the annual report. Much credit is due to those larger companies which have introduced some reformation in balance sheet set-up, although the bulk of reports which I have seen in the past two years still carry the balance sheet in traditional form. Another reformation of the last few years is the elimination of cent figures. Recently there came to my attention the annual report of one large English company with subsidiaries all over the world, the financial statements of which were expressed throughout in even thousands of pounds.

The balance sheet of this same company is one of the most modern I have ever seen. It is broken down into two main headings: (1) *Capital Employed,* under which is set out share capital, profits retained in the business, loan capital, and outside shareholders' interests in subsidiaries, and (2) *Employment of Capital,* under which is set out a brief description of fixed asset accounts and their total followed by description of current assets and current liabilities and total, showing net current assets. Thus, the balance sheet of this very sizeable and complex group of companies is placed before the reader as a one-page picture which can be read and understood very quickly. The report contains supplementary statements and reconciliations covering the main items shown in the balance sheet which provide the reader with the opportunity of satisfying himself as to the break-down of the major figures. This report, the 1953 Report and Accounts of Unilever, stands out as a masterpiece of clear-cut presentation throughout. In my view it is a most expertly prepared report because it sets out so comprehensively the company's performance, not only for the period of account but for prior periods as well.

Trend to Uniformity

A review of a substantial number of reports issued in the past five years shows that professional accounting firms are gradually reaching some semblance of uniformity in their reporting methods.

However, the practising accountant seems to have exercised less influence than he might on that portion of the report for which his certification is not required. I am referring particularly to that section of the text which is devoted to an explanation by the company of financial statements which have been certified to by the auditors. I feel that the practising accountant must still make some further contribution toward the achieving of better standards in this particular phase of company reports. One step in that direction would be for him to have a less self-effacing attitude at the time his client's report is being prepared. This he can do by seeking, or insisting upon having, the opportunity to review the report before it gets to the printing stage.

Is Statement True and Correct?

While the auditors' report, in almost all instances, is technically definite in certifying that the named statements present "a true and correct view of the state of the affairs" or "present fairly" the financial position of the company, it not infrequently happens that the company's explanatory text dealing with the financial statements holds forth a view that is not as "true and correct" as would have been the case if the auditor had been consulted in the course of its preparation.

In my view the entire report of the company is considerably strengthened when the auditors' certificate or report refers to the fact that he has made a review of the financial explanations presented by the company. Of a large number of auditors' reports examined, I have come across only isolated instances where such reference is made. In one of these there is embodied in the certificate the phrase "and have reviewed the explanatory section appearing on pages (such and such)". In another instance, the certificate states, "The supplementary statements (and these are identified by number) fairly present the historical financial data for the years included therein". In another case the certificate includes the following words, "In our opinion the foregoing balance sheet and related statements of income and surplus read in conjunction with the comments contained in the president's report under items numbered (and the numbers are listed) and general comments present fairly the position . . . .".

Don't Minimize Auditors' Report

The frequent practice of placing the auditors' report at the bottom of the balance sheet in type of almost unreadable size has tended to make this highly important feature of an annual report the one least noticed by shareholders. In my view the main financial statements, that is the profit and loss account and the balance sheet, should be preceded by the auditors' report, and the independence of the auditors' certificate is probably better accentuated by use of a facsimile of the actual auditors' report, showing the firm's letterhead and signature and set out apart on a single page devoted solely to the purpose of that report. It is easy to agree with the observations of one writer who commends some presidents for making reference to the auditors' report. This writer suggests that "this reference should make it clear that the auditors' report is professional confirmation and authentication of the company's financial statements and, as such, is an additional assurance and protection to the stockholders".

In the course of his examination, the practising accountant should make himself fully aware of any new and unusual developments that have occurred within the company during the year and should be readily available to discuss with the chief financial officer the various treatments which would conform with good accounting practice. The practising accountant can usually be much more in-

fluential in directing the company to present its financial statements in a manner compatible with his requirements, when he has made his suggestions and used his influence in that direction before the company's preliminary accounts are drawn off.

Sale and Lease-Backs

The accounting profession still has some major problems to deal with and while this matter is probably outside the ambit of this paper I would like to mention one which stands out as important. I refer to the matter of sale and lease-back deals and major lease commitments which involve substantial contractual payments over future years but do not show up in the financial statements or reports of companies. Companies can get into a serious financial condition as a consequence of large fixed lease payments just as easily as they can as a consequence of large fixed interest payments. The omission of this data from statements and reports is a matter of real interest and concern of investors as well as of shareholders.

The primary responsibility of the outside auditor is of course to shareholders on whose behalf he is appointed. This means that he should protect the shareholder against any misinterpretation by management. In offering his written opinion for inclusion in the company's annual report, he thereby associates himself with the report as a whole. Although he certifies only that the technically described figures appearing in the financial statements are correct or present a true financial view, he should take some reasonable measures to assure himself that the management does not, in its financial narrative, give to the shareholder an interpretation of its financial picture which is not justified by the facts.

In this connection we should take note of a factor which has been developing to a more important extent in recent years. I refer to the increasing holdings by insurance companies, pension funds, or the public investment companies of blocks of common stocks. This class of shareholder, the professional investor, has long been important in the bond market, and any company deciding to borrow money on a bond issue has had to satisfy their exacting requirements for information as well as to meet certain requirements laid down by law. The present extent of the professional investors' interest in equities, as opposed to debt obligations, means that any public company whose shares are actively traded in must be prepared to meet their continuing and searching scrutiny. The deep searching analysis of these financial experts is quick to reveal the elements of strength or weakness in a company's position as disclosed by its report and equally as quick to detect the omission or suppression of information that an intelligent shareholder should demand.

Thus the shareholder on whose behalf the professional accountant acts as auditor is, so to speak, also becoming a professional. That fact does not add to the weight of responsibility resting on the outside accountant which would be just as great in any event. It should, however, strengthen him in getting his recommendations carried into effect.

Summary

Before parting with the subject, I conclude by offering a brief summary listing of the items that in my opinion represent minimum information that should be included in an annual report.

1. A review of the affairs of the company in reasonable detail for the period under review together with similar background information about conditions and developments in the industry of which the company forms a part.

2. A balance sheet in modern form including breakdowns of larger figures and notes on the basis of values of the larger asset classifications, and sufficient foot notes to enable a stranger to determine the basis of compilation of consolidated statements, the rates and methods used in the calculation of depreciation reserve. The comparative balance sheet as at the end of the preceding year and, where practicable, comparative main balance sheet figures for ten years.
3. An income account starting preferably with sales and carrying on through to a reconciliation of surplus for the year under review and for the preceding year, together with a statistical appendix setting out these figures on a comparable basis for a five or ten-year period. Analysis of the income account in sufficient detail to show significant ratios, such as profit on sales, profit on capital employed in business, coverage of interest charges, coverage of preferred dividends, earnings and dividend per share of common stock.
4. A source and use of funds statement in reasonable detail for the year and the preceding year and, where practicable, a similar statement for the preceding five or ten years, provides a very useful feature.

Essentially, the report with its accompanying financial statements can be judged as to adequacy on one simple criterion: can existing and prospective shareholders come to an informed decision as to the value of the shares of the company from a study of the published annual financial statement to the extent that this value is covered by financial factors?

A Letter from a Reader

Montreal, Sept. 22, 1954

OLDEST PROFESSIONAL BODY IN BRITAIN

Sir: I would like to apologize for referring to the English Institute as the "oldest professional body in Britain", in my address published in the May issue and I thank Mr. A. N. Stewart for his letter in the July issue commenting on it.

Having just returned from Britain where I was a guest at the centenary celebrations of the Scottish Institute in Edinburgh, I now have good cause for realizing the inaccuracy of my statement, which was made in a public address one year earlier. As a member of the Institute of Chartered Accountants in England and Wales I now feel like a junior called to order for lack of respect to a senior! I may say, however, that the senior Institute gave me a royal time in Edinburgh and I kept very quiet about by overseas indiscretion!

KENNETH F. BYRD, A.C.A.

Efficient Administration—
How Does Your Business Rate?

By George Aitken, C.A.

Good administration must be planned and worked at continuously

THE spectacular rise in costs of goods and services during the past decade has turned the spotlight on administration. In this period of intense competition, efficiency in administration assumes new and increased importance.

It may well be that economies in this field will provide the margin necessary for private enterprise to maintain profits. By similar economies, government could be aided in coping with its ever-present problem of keeping expenditures within the range of available revenue. The Canadian Chamber of Commerce, earlier this year, commended the Federal Government for its efforts in this direction but strongly urged that administrative practices be further analyzed.

Reduced to the simplest terms, what are the earmarks of an efficiently run business? It is my view that the efficiency of an organization may be gauged by its ability to supply goods or services of a high standard when they are wanted and at reasonable cost.

Good administration is not accidental. It does not "just happen". It is something that must be planned and worked at continuously. Management must use all available means and all its skill to achieve it. In this paper those things which contribute to effective administration — things which, used in proper corelationship, are fundamental to the success of businesses, large or small — will be discussed under the headings of organization, personnel, procedures, and control.

Organization

Good organization is fundamental to efficient administration and, in my opinion, clearly tops the list of check points in any effort to evaluate how well a business is being run. The basic requirements of good organization are:—

1. It should meet the needs of the particular business at a specific time, but it must be flexible enough to meet changing conditions.
2. It should not have any more levels of authority than absolutely necessary — the number will be dictated by the size and nature of the business.
3. The responsibility for every important function should be definitely placed and the necessary authority should be vested along with responsibility.
4. It should have balance by having each major function represented at the

A paper read at the 1954 annual conference of the C.I.C.A., Winnipeg, August 24

various levels of management with the necessary weight of authority.

5. The span of control of an officer should not be too wide. He should act as referee only for as large a group as he may conveniently direct.
6. It should be capable of being translated into an organization chart. This is very important. An organization chart is so fundamental that its need, both for the entire company and also within divisions and departments, should be accepted as an established fact. Yet, in practice, there is not sufficient emphasis placed upon it. (It is rather astonishing to find how few companies have a formal chart of company organization. Is its absence attributable to indifference, or to failure to realize its potential value, or to the desire to avoid taking issue over the division of responsibilities?)

To prove the importance of a sound organization chart let me list the things which it accomplishes: —

1. It will give everyone in the organization the knowledge of what his own responsibilities are, the responsibilities of others within the corporate framework, and his relationship to them.
2. It will clarify both intra-company references and contacts from the outside business world. Establishment of similar titles for positions of similar authority will help to avoid disgruntlement throughout the supervisory ranks.
3. It will be possible to visualize those areas where greater depth of management is required. This is especially true in a rapidly expanding organization.
4. In pointing out the need for delegation of responsibility it will enable each official to find more time for planning, for developing long-range programs, and for handling special projects over and above his direct supervisory duties.
5. It will help to indicate the areas where administrative assistants may be used to relieve senior officials of time-consuming research and case work.
6. It will help to regulate and direct informal organization. I should like here to emphasize the importance of the so-called informal organization — that part which is governed by the informal contacts, social groupings, lunch and coffee-period acquaintances. Its effect on administration cannot be ignored. We must try to understand it and act intelligently about it.
7. It provides each key person with added incentive through knowledge of the successive positions to which he may aspire.
8. If it is used to depict not only current situations but also to reflect theoretical complement, it may then function as a guide to the planned staffing of presently unfilled positions.
9. By projecting it into the future and taking account of retirements, known physical disabilities, and similar circumstances it shows where potential replacements should be developed in the organizational pattern.
10. It helps to improve communication and coordination within the company.

In this connection I should like to mention one means of improving communication and coordination which has been used in our own company for a number of years. A meeting of officers heading up all functions of the company is held once each month. The chief executive officer reviews the financial condition of the company and also comments on all important matters affecting the organization which may be purely internal in character or may take the form of analytical comment on economic condi-

tions, business trends, legislation, or other outside influences. The meeting is conducted as an open forum and everyone is invited to ask pertinent questions or to offer comments based on his own interest in the subject. This type of meeting is, in my opinion, extremely beneficial, for it enables each officer to become better informed on the business of the company as a whole and to take back and disseminate to his own division or department a consensus of informed views on company affairs.

The foregoing points will demonstrate the practical value of establishing well-defined channels of command expressed in chart form and promulgated to all key personnel. This step alone can eliminate misunderstanding, duplication, and over-lapping which in themselves are often at the root of waste and inefficiency.

Personnel

The calibre of the personnel within a company is so important to the achievement of efficient administration that personnel ranks second to organization in this discussion only because it is impossible to select and appoint key staff until the basic organizational structure has been designed.

It is not my intention to deal with the humanities of personnel. I think all of us are deeply conscious of the importance of satisfying the psychological needs of people if we want the best possible fruits of their labour — the need of the individual for recognition, for acceptance by his superiors and associates, for a sense of responsibility and accomplishment. These are all vital but do not come within the scope of this paper.

The broad problem of dealing effectively with even a moderately large staff immediately points to the need of a central personnel function. Standards of selection regarding education, age range, physical fitness, and prior experience must be established; aptitude tests to determine potential ability on varying types of work must be given; contacts with useful sources of acceptable employees must be maintained. These and similar matters can best be administered in a department comprised of people who have proven ability in the personnel field. It is virtually impossible to measure in terms of dollars and cents the value of top grade selection of staff.

Mr George Aitken, C.A. has been a member of the Manitoba Institute since 1929. He joined The Great-West Life Assurance Co. in 1934 as chief accountant and is today assistant general manager and comptroller. He is a past president of the Winnipeg Chapter of the National Office Management Association.

However, one needs only to consider the expenditure of staff time in interviews, orientation, and training to conclude that it is a costly business to recruit anyone who is unlikely to prove capable and reliable; furthermore the loss of an employee, once he has been trained, is a financial drain on the company. It follows, then, that the personnel department should use every resource at its command to acquire those people who are most likely to make a positive contribution to company output; this department should likewise give stimulus to all factors which will tend to retain present key staff.

What, then, are the check points which will help to determine whether the personnel of the organization are being given the opportunity to do their most effective work? I would head the list with those activities of the personnel department which ensure that the salary fund is administered fairly and equitably. These would normally include an ade-

quate job-evaluation system and a salary standardization plan.

Job Evaluation

The first step in establishing job values is the preparation of a description of every job in the company by an independent, unbiased writer, preferably a member of the personnel department. The write-up refers strictly to the job, not the capabilities of the person holding it, and should be uniform in style giving due emphasis to all important duties. These job write-ups should be reviewed with the supervisor of the job as well as with the officer concerned.

The next step is the appointment of a job-classification committee which may be comprised of administrative officers selected from larger representative units. The function of the committee is to ensure consistency in the classification of jobs throughout the whole organization. To that end the committee will give similar weight to similar work and will assign a job rating in accordance with a comprehensive set of definitions. They will periodically review all new jobs created and all jobs where there is substantial change in duties. The classification committee will then recommend a salary scale to take care of all classes of jobs indicating specifically the minimum and maximum for each job class.

Salary Standardization

The executive officer responsible for the administration of staff salaries, acting on the advice of the personnel department, will determine the policy for frequency and size of salary increments within the salary scale for various standards of work performed. Review for determining the necessity of adjustments in salaries should be made at regular intervals and not less frequently than annually. As a prerequisite to the annual review of salaries a merit rating should be obtained for each employee. This is the supervisor's rating of the quality and quantity of work performed, attendance and punctuality, personal attributes, promotability, etc. Resting as it does on general appraisal rather than on any scientific formula, the merit rating can and does fluctuate in direct ratio to the supervisor's view of his subordinate — sometimes benevolent, sometimes highly critical. In order that performance on the job will receive its proper reward particular emphasis must be placed on the necessity for consistency of ratings as between departments and divisions.

Staff Welfare

A vital factor in staff relations is an adequate welfare program. Administered by the personnel department it covers on the one hand a wide and varied field including staff medical care, sick leave with pay, days off, vacation, long service recognition. On the other hand any modern welfare plan will include group life insurance, accident and sickness insurance, and an adequate pension plan. Major medical coverage is also coming to the fore. The benefits provided under these plans should be designed to meet the particular needs of the people who make up the organization. If these plans are properly explained to the staff and fairly administered, better morale and improved performance, particularly through the removal of the threat of financial distress, will be a natural result.

Orientation

An adequate personnel policy will include some formal orientation on the job. It is a known fact that people do better work when they have a clear-cut idea of the objectives of their own job and understand its relationship to the overall goal of the company.

A comprehensive orientation program will include a resumé of company history and company objectives, a description of the character, area, and scope of

company operations, and, besides the usual review of working conditions and introductions to fellow workers, a careful description of auxiliary welfare plans.

Our own program of orientation touches on all of these matters, and two particular points are worthy of note. After one month's employment the personnel department reviews the new employee's work with him and makes sure that all questions regarding work conditions are answered. Within the first six months the new employee is invited to attend a formal program of orientation which consists of ten one-hour sessions. There is a general review of the company's history, its organization, objectives, departmental set-up, and an outline of some of the more important company policies and procedures. The series is concluded by a conducted tour of all departments of head office. We endeavour to take all reasonable steps to make the new employee feel "at home" and to instill a real sense of belonging to the organization.

Training

Although the functional responsibility for the staff-training program lies with the central personnel department the administration of the program is generally widespread involving officers, department heads, and key personnel. When considering training requirements we must bear in mind that there are two distinct levels of staff, each calling for a different technique. The first level is the experienced staff member holding a supervisory or key position; the second, the new staff member recruited at a junior level. A practical program of training for supervisory and key people will include direct personal counsel, particularly on case work, formal group meetings, reading assignments, attendance at technical educational classes (in some instances encouraged by company subsidy and company awards), attendance at technical conferences conducted by professional or industry organizations, and encouragement of self-training.

The educational program in our own organization may be of interest. A regular series of lectures is conducted each winter covering subjects related to life insurance. Most of the text material, the syllabus, and the regular examinations have been developed by such organizations as the Life Office Management Association, the Life Insurance Institute of Canada, and the Home Office Life Underwriters Association. Diplomas are granted on the successful completion of prescribed examinations covering several years work and give recognized standing in life insurance circles. Many of our staff attend these lectures each winter. This extension of formal education has been of great benefit to the industry.

The training of juniors and new recruits will generally be in the hands of supervisors and key personnel and will be carried out by explanation, demonstration, and supervised practice on the job, by sampling and backchecking the quality of work performed, and by the use of check lists of important parts of the job. While detailed instructions can be given by a senior person it is the direct responsibility of the supervisor to ensure that the staff member is trained.

Perhaps no other single phase of personnel work can be so productive of savings in overall cost of administration as a sound training program which reaches out to all members of staff. The training and educational facilities made available, while of direct benefit to the staff, will unquestionably pay rich dividends to the company.

Procedures and Methods

The overall system of a company is made up of procedures and carried on by methods which are designed to meet efficiently the needs of the organization at a stated point in its development. Year

by year changes in an organization or changes in business conditions may throw the procedures and methods out of gear. Remedies are applied to cure obvious ailments often without getting to the root of the trouble.

The question as to whether a system is good or bad is not answered by the statement that it works. A very bad system can sometimes be used with many outward signs of success; closer investigation, however, may reveal that its wastefulness and inefficiency have been taken for granted and the staff operating the system have somehow become capable of turning out acceptable work.

To play their part in achieving good administration, procedures must be subject to control and must undergo some form of regular inspection. This is to ensure that they are operating according to plan. Additionally, however, they must be subjected periodically to intensive scrutiny and overhaul. It is safe to say that this stage is reached when a system has been used without change for a period of ten years; it may even become obsolete in a much shorter time. It is fortunate that this whole area lends itself to a logical, studied approach. Perhaps these are the most important general questions to ask in a systems investigation: —

1. What is the primary objective of this particular system?
2. Does a transaction follow a logical flow of work in reaching completion?
3. Can the expenditure of time or the use of equipment be reduced with respect to operations, transportation, storage, or inspection?
4. Does it contain proper internal controls against errors and irregularities?
5. Have secondary objectives been added which can be eliminated or handled in a more direct way?

Improvements in procedures will be based on the established principles: eliminate, combine, change sequence, and simplify. In no other area is it possible to make such demonstrative savings or to value them with such exactness.

I want to digress for a moment to talk about what, for want of a better term, I will call job make-up or job content. A few years ago when staff shortages and staff turnover became, for a period, the most frustrating problem of management, the obvious solution will lie in the simplification of individual jobs. Work processes were in many cases broken down into the simplest possible steps and a staff member would be assigned a few of these elementary things to do. Some little time elapsed before it was found that this was aggravating the problem rather than correcting it. People just do not like dull chores which are completely lacking in challenge. Average people soon lose interest in oversimplified jobs with a consequent decrease in productivity and a higher rate of turnover. In our organization we have had numerous instances where production was increased as much as 25% through increasing the variety in the job content.

Selection of the method of doing work requires good judgment and common sense. Improvements in cost are frequently attributed to the use of punched card equipment as compared with bookkeeping machines, multiple copy forms versus routed forms, typewriter rather than manual methods when the improved cost should in fact be attributed to the general clean-up of the procedures through elimination, simplification, and so on. There are situations on the other hand when radical equipment changes are called for. The current high cost of man-hours computed in terms of salary, space, and overhead compared to the versatility of office machinery available today makes it economic to follow a plan which provides sufficient quantities of high quality machines suited to the tasks to be performed. If anything, there is

perhaps a tendency to be penny-wise and pound-foolish when it comes to purchasing office machines and equipment.

An investigation we made recently of one of our minor systems illustrates how these steps are used. This system was installed more than ten years ago and was apparently operating satisfactorily. Cheques were written promptly and despatched without delay; information could be obtained quickly; ledgers were balanced daily. Yet our unit costs of handling appeared high and the planning department undertook a study of the system. Each step was charted by the planning department using the customary symbols for operation, transportation, storage, and inspection. This analysis revealed that the various steps in the system were handled in no less than five departments.

In diagnosing the faults in the system it appeared that many secondary objectives had been overemphasized as a result of independent action taken by the several departments involved to speed up processes and establish additional controls. The planning department then applied the principles of elimination etc. to the end that a system was devised and the final recommendation showed that the procedure had been confined to three departments and further simplified to the following extent: —

	Orig.	New	Saving
Operations	124	48	76
Transportation	80	43	37
Storages	97	54	43
Inspections	21	7	14
Distance travelled	3.453 ft.	1.483 ft.	1.970 ft.

I want to mention briefly three other points that came within this part of the discussion.

Printed forms, which are in themselves such valuable instruments in any company system, nonetheless require careful control. While the printing costs of the forms are sizable it must be remembered that the processing cost is even more important. A continuous program of review and revision must be carried on. In our own company (which uses over 2,500 forms printed in English and French) one member of the planning department spends full time on form design and control. This is quite apart from the routine inspection of all reprints carried on by our printing department.

The problem of storage and retention or destruction of files and documents takes an important place under this general topic of systems. We must devote the time to an intelligent scrutiny of all this material to determine its safe storage and ultimate disposal. In our own company a committee meets each week to carry out this responsibility.

Last but by no means least important in this area is the question of adequate space of a suitable character to enable efficient integration of all company operations. Provision for the arrangement of divisions and departments down to the smallest work units to permit the normal flow of company transactions has a vital part in overall efficiency. Lighting, sound conditioning, ventilation, and maintenance cost of working areas all enter into our consideration of space.

Control

It has been evident from my comments thus far that adequate inspection and control must permeate the entire company operation. Each organization must devise suitable indices to determine that its policies are having the desired result. Here are some of the types of information which will facilitate top-level control: —

1. Monthly statement of financial operations supported by such information as will pinpoint all major operating indices.

2. Statements of current unit costs of operations for head office and branch organizations with comparisons indicative of trends in costs.
3. Periodic budget statements setting actual results against planned performance which has been forecast at least 12 months ahead.
4. Comparative statement of sales by territory.
5. Statements of personnel employed by departments and divisions flagging up increases or decreases in personnel and the number of unfilled positions. These statements should be related to departmental production figures.
6. Operating reports interpreting all important factors at the divisional or departmental level.
7. Special research reports on major financial, production, or other specialized fields of operation.
8. Reports by the internal auditor and the company's outside auditors.

It is very important that detail in all reports be kept to a practical minimum and timeliness and interpretation of results receive major emphasis from those charged with the responsibility for the preparation of accounting, statistical, and research reports.

The remainder of this paper is devoted to some observations on how all of these fundamental principles of organization, personnel, procedures, and control are used as check points by staff men and outside organizations.

Planning

At the outset I would state that the planning concept and approach must be basic in the thinking of all executives and supervisors. We must recognize, however, that the responsibility for getting the job done will always loom foremost in the thinking of those responsible for direct company production and will greatly transcend time spent in detailed planning. In larger organizations it is therefore economical to place a staff of planning specialists at the disposal of officers and department heads. This is so because planning requires constant attention and cannot be left over "until time permits"; it requires consistent application throughout the company and a reasonably uniform type of approach. Furthermore, many operations are company wide and require objective study outside the boundaries of one department or the sphere of authority of one officer. New equipment is being developed daily and it is impractical to think that all supervisory personnel will or should follow these developments closely. A staff man can and must be thoroughly familiar with the newest machine methods which may be utilized by his company. The characteristics of a good planning unit are well known, but some are worth reviewing. It must have leadership with the faculty of original objective thinking; it must have the ability to engender enthusiasm for new ideas; it must give credit to the line operating departments for the cooperation and ideas which they have afforded; it must have patience and persistence in working out its problems.

There are various ways of carrying out the staff planning function in an organization. In our own company the planning unit review various company indices including budget reports, unit cost comparisons, and reports on staffing to ascertain areas where the greatest benefit may be obtained from the planning manhours expended. They then move into that area and make an intensive review of organization, then personnel, then procedures and methods. Work flow charts are prepared and machine methods are investigated. Proposed changes, no matter how unimportant they may seem, are reviewed with the department concerned and discussed at officer level. If their recommendation regarding a proposed

change in organization or procedure is approved the actual installation is supervised by the planning unit and a further check made usually following four or six months of operation to make sure that everything is going according to plan.

From my observation of this work I would say that the approach of the planning unit closely parallels that of the management consultant. In addition to executing major procedural changes in the company our planning unit is used extensively in a consulting capacity on a myriad of smaller problems working within the framework outlined earlier. This unit has been able to produce dramatic results in the way of savings and improved efficiency.

Internal Auditor

The internal auditor can make an extremely important contribution to effective administration within the organization. The function of internal auditing has broadened greatly in recent years so that in many companies it is no longer limited to the examination of accounting and financial operations and the verification of assets and liabilities. In today's concept the internal auditor heads an independent appraisal activity within the organization which functions by evaluating the effectiveness of other types of control. He is therefore in an ideal situation to render constructive service to management by reviewing and reporting on matters of operating efficiency.

In our own organization we subscribe to this broader concept of the internal auditor's function. In this connection the inspection of our branch offices provides as good an example as any. There are 54 in number spread across Canada and the United States. The internal auditor visits the branches at stated intervals and in addition to his work on financial and accounting matters he is specifically charged with the responsibility of scrutinizing staffing, office layout, work flow, procedures, and work standards. His regular program of examination covers specifically adequacy of personnel, supervision, staff training, destruction of records, requisitioning and storage of supplies, work distribution, office equipment, and office space. At the conclusion of each visit the internal auditor outlines in writing to both head office officials and branch officials his views on the operations of the branch. We believe there is very considerable benefit from the integration of this work with that performed by the department directly responsible for field office supervision.

Management Consultants

If we have a planning function which operates satisfactorily and if we have capable planning-minded executives and supervisors what conditions would justify the employment of management consultants?

Management consultants may be engaged:—

1. After a period of rapid expansion to realign policies, organization, etc.
2. When entering upon a period of expansion or entry into new lines of business.
3. Merely as a check that the business in all its ramifications is operating efficiently.

On the other hand their assignment may be on a much narrower basis, for instance for the examination of a special machine application or the solution of some special problem concerning organization or personnel — such as installing a job-classification system or the finding of personnel for stated key positions. If an organization has had no previous experience with management consultants perhaps the following points will be helpful: —

1. Select a reputable firm and become acquainted with the principals.

2. Enquire from former clients as to the firm's ability to do a job of the size and scope you want.
3. If feasible have the consultants undertake a limited assignment and critically examine the results.
4. Work on an agreed fee basis with a clear understanding of what is to be produced.

Our own experience with management consultants has been favourable. In the most recent of such engagements our primary objective was to carry out a brief program of training for officers and supervisors. To this end our consultants conducted a supervisors' seminar over a period of three months. In addition they conducted an overall examination of our policies and procedures. As a result of their work we felt that supervisors and officers took a new and more enlightened interest in their problems with a consequent improvement in supervision. A very large percentage of their recommendations regarding procedural changes were adopted, some 60% by number. Many of these, of course, originated in our own organization but had the benefit of independent, unbiased, and capable review. It is my own opinion that an overall review of this nature can be carried on to advantage at reasonable intervals. An eight-year cycle might be appropriate depending on all circumstances, with special assignments in between as required.

Outside Auditors

Many of my remarks with reference to the role of the internal auditor and management consultants can be applied with equal force to the work carried on by outside firms of chartered accountants. Here we have a group with special qualifications and unique opportunities to judge the overall company and in particular the effectiveness of its policies, procedures, and control. Their relationship to the company is more intimate than any other outside organization; their connection is generally more lasting.

We are well aware of the fact that some of the larger firms of chartered accountants have developed parallel services in the management counselling field. But my present remarks apply in particular to the regular work carried on by any practising accountant on behalf of his client. Those of us directly responsible for administration welcome practical suggestions aimed at the solution of problems of organization, personnel, systems and procedures, and control. The role of the outside auditor can be valuable in the extreme if he will extend his examination beyond the pure accounting system to include a critical review of all of these factors. If his own work in the examination of the accounts is impeded by lack of internal control, by delays in the production of information, by abnormal error ratios, by cumbersome methods and complicated procedures, how much more valuable is a recommendation which gets to the grass roots of the difficulty than any amount of time spent in verifying the accuracy of the final results. Where this concept does not exist, I am positive that it would require only a brief round table session with the accounting executive to work out a thoroughly practical working relationship which would be of direct and lasting benefit to the client.

Conclusion

At the beginning of this paper I indicated that I was going to comment on the checkpoints by which I would rate the effectiveness of administrative procedures. It is my belief that each and every one of the steps outlined here is fundamental. However I do not want to imply that the techniques need be as extensive as described — naturally the circumstances of each business will indicate how far it is practical to go. These are

the philosophies and techniques which, in combination with skilful coordination and aggressive leadership, can only result in effective administration.

Our interest in this problem, either as chartered accountants engaged in industry or as practising accountants acting on behalf of the shareholders, should be directed to equipping ourselves to meet the challenge of the more exacting problems which the future in this field holds in store.

A Recent Book

Local Authority Finance, Accounts and Auditing, by J. H. Burton; published by Gee & Co. Ltd., London; pp. 295 and index; price 25/-

This book was published originally as a text for the young British student of local government accounting, finance, and auditing, and also as an introduction to the above-mentioned subjects on the course of the Institute of Municipal Treasurers and Accountants. It consists of 36 chapters and deals with the responsibilities of the chief financial officer, supervision and control, expenditures, income, budgetary control, ultra vires payments, efficiency in municipal administration, and internal, statutory, borough, government, and professional audits. It also outlines some of the frauds which have taken place in various levels of government in England.

The author discusses at some length the point that in the British Isles the accounts of most local government authorities are audited by government or "district" auditors who are on the staff of the Ministry of Health, under which department the local governments function. These auditors have very wide powers. They may disallow any item which has been paid contrary to the law and "surcharge" the person or persons responsible for authorizing the expenditure or incurring the loss. While local governments may choose an independent professional auditor if they wish, comparatively few do so. Apparently the author himself favours the choice of the Ministry of Health auditors since they "have a much superior knowledge of local government finance, administration, accountancy, and law". Here, however, lies a very serious problem for the public accountant who accepts an appointment as auditor of a municipality in Canada. One of the characteristics of municipal accounting is the legal framework within which accounts must be kept, and yet it is a very onerous task for any professional public accountant to familiarize himself even reasonably well with it.

Unfortunately the author has made no attempt to approach his topics in a systematic way and it is very apparent that the various chapters have been taken from lecture material. As a result the text contains a considerable amount of repetition. Nonetheless it is very interesting and stimulating, and any one interested in municipal government will find it of great value.

PAUL HICKEY, C.A.
Hamilton, Ontario

Was Shakespeare an Accountant?

By Derek Lukin Johnston, C.A.

Some have thought that the immortal bard was Francis Bacon, a lawyer, but internal evidence strongly suggests that he was an accountant

I AM well aware that in claiming Shakespeare as a principal forerunner of the modern chartered accountant, I am taking arms against a sea of troubles. The theories about Shakespeare's life and the authorship of his works are almost innumerable, and each one has its own guard of vigilantes ready to pounce upon a newcomer. However, the poet himself has written:

> We must not stint
> Our necessary actions, in the fear
> To cope malicious censurers

and so I shall proceed to my thesis that William Shakespeare trained and practised as a professional accountant before, and perhaps even while, he wrote his plays and sonnets.

First, let us look at the circumstantial evidence afforded by his works. The most casual reading of these shows them to abound with references to audits, accounts, and taxation. Hamlet, tormented by thoughts of his father murdered in his sleep with no chance to confess and be shriven of his sins, cries out,

> And how his audit stands who knows save heaven?

At the outset of the same play we find some words which surely are a cry from the heart of an accountant in the throes of the busy season:

> What might be toward, that this sweaty haste
> Doth make the night joint-labourer with the day?

In *Othello* we find the Duke addressing Desdemona's father in the very terms with which a modern auditor might instruct his articled student:

> To vouch this, is no proof
> Without more wider and more overt test.

Later, Othello cries to Iago,

> Give me the ocular proof

— a sound principle of auditing which has stood the test of time for 350 years.

In *Much Ado About Nothing* Leonato says in the first act,

> You tax signior Benedick too much

— an obvious literary sequel to the author's appearance, on behalf of a client, before an Elizabethan income tax appeal board!

In the first part of *King Henry IV,* a thief speaks of his prospective victim as

> a kind of auditor
> One that hath abundance of charge too, God knows what.

(I hasten to point out that there is no

A radio talk over the C.B.C., September 12, 1954

implication here of the auditor charging excessive fees; in the context the word "charge" relates merely to the moneys which he is known to be carrying.)

Inflation was a problem in Shakespeare's day as it is in ours, and when Falstaff remarks in Act IV of *The Merry Wives of Windsor* that he had been

Set in the stocks, in the common stocks

surely it is naive indeed to find only a reference to punishment, and not see deeper into the sound financial advice that Shakespeare the accountant was giving to his audience.

Then in *King Henry V* that rascal Pistol, planning to be a war profiteer, uses phraseology that could only have been placed in his mouth by a professional accountant:

For I shall sutler be
Unto the camp, and profits will accrue

I think I have quoted enough, from many examples, to show that Shakespeare was thoroughly familiar with the best professional auditing and accounting standards of his day. Some victims of my theory have expressed surprise that the practice of auditing was common in Shakespeare's time. The art of auditing goes back at least to Roman times. The word "audit" derives from the Latin verb *audire* — to hear; for it was the custom for the auditors to "hear" the "accounts" of transactions which stewards, or agents, gave verbally. In medieval times the great English universities used to brew a specially strong ale on the occasion of "audit days", and this was known as "audit ale". I commend the revival of this pleasant custom to modern business.

Where did Shakespeare obtain his detailed knowledge of professional auditing and accountancy? Let us first consider the three major questions which form the kernel of the so-called Shakespearian mystery: —

1. How did the son of a poor yeoman in Stratford acquire the extraordinary range of classical, historical, and general knowledge which is demonstrated in the plays?
2. Between 1585 and 1592, we have not a single documented fact about William Shakespeare. Where was he during all that time?
3. The location of at least ten of his plays is Italy, and in these Shakespeare displays a remarkable knowledge of Italian geography and language, knowledge virtually impossible for him to acquire without having visited Italy. Why did he go to Italy, and where did he stay when he was there?

Among the existing theories, I cannot find one that fits the problem so easily and adequately as that which I am going to propound: —

Shakespeare went to Italy to study the new art of double-entry bookkeeping and, in all probability, articled himself for the usual term of five years to one of the distinguished Italian accountants who were at that time far and away ahead of their professional colleagues in other countries. Double-entry bookkeeping, the means of recording financial transactions employed by 99% of the business world today, was invented in the wealthy trading cities of Renaissance Italy The first known work on the subject was published by Fra Luca Paciolo in Venice in 1494, and he was followed by other accountants in the 16th cenury: Manzoni in Venice, Pietra in Mantua, and Grisogono of Dalmatia (the Illyria of *Twelfth Night*). All these places are frequently mentioned in Shakespeare's Italian plays.

Now the biographers and researchers have been assiduous in their efforts to find traces of Shakespeare in Italy. They have pored over the records of the Renaissance houses of learning, they have

ransacked the university registers, even to finding two students named Rosencrantz and Guildenstern on the rolls of Milan University in the 1590's. But . . . not a clue about Shakespeare. The reason? The professors have been barking up the wrong tree. Let them search counting house records, registers of apprentices to the bankers' or the goldsmiths' guilds, and see what they find. I suggest that Shakespeare was apprenticed for five years to a professional accountant in Venice, Mantua, or Padua, and finally returned to England as a qualified accountant, settling down to practise with all the prestige of a specialized training acquired abroad. As additional evidence, I cite Shakespeare's use of the technical accounting phrase "Debitor and creditor" — to be found in *Othello,* Act I and *Cymbeline,* Act V — which I believe to be the first recorded mention of double-entry bookkeeping in England.

What made him give up a profitable accounting practice and turn to the romantic but less secure field of drama and poetry? Perhaps he tried writing and acting as a hobby, and when he had achieved some success he did not feel he could return to the sober world of ledgers and vouchers. Perhaps the change was gradual and for a time he continued his accounting work by day, and went on the boards by night. His growing interest in the theatre at this time is well expressed in the words uttered by Puck in Act III of *The Midsummer Night's Dream,*

> I'll be an auditor;
> an actor too, if I see cause.

It has been held that since the plays are full of allusions to lawyers, mortgages, leases, etc., Shakespeare was once a practising attorney. Nonsense. My good friends in the legal profession tell me that although there is much good law in the plays there is also a deal of bad law. It is my own impression that where Shakespeare is dealing with business, contracts, bonds, etc. he is accurate, and this of course one would expect from his accountant's training in basic commercial law. But when he gets into criminal law I think he bogs down hopelessly.

The trial scene in *The Merchant of Venice* provides a splendid dramatic vehicle for Portia's "quality of mercy" speech, but as an example of a civil case where one party is on the point of being allowed to commit murder under the noses of the judge and jury, I cannot think it would stand the scrutiny of the Council of the Law Society for five seconds.

Besides, what lawyer with any conception of loyalty to his profession could let creep into his published work the phrase, "the law's delays" uttered by Hamlet in his most famous soliloquy? Or the proposal by one of Jack Cade's rebels in the second part of *King Henry VI,* Act IV, that

> The first thing we do, let's kill all the lawyers.

It is true that a few moments later in the same play, Jack Cade and his followers hang the clerk of Chatham, who appears to have been an accountant of sorts. However, the clerk allowed his name to be mentioned publicly as a specialist in reading and writing, and I think Shakespeare permitted his execution simply as a dreadful warning against self-advertisement and similar breaches of the code of professional ethics.

My case for Shakespeare the accountant rests, and I submit it confidently to the audience in the words of Flavius, the steward, to his master Timon of Athens, in Act II,

> If you suspect my husbandry of falsehood,
> Call me before the exactest auditors
> And set me on the proof.

Report of the 1954 Annual Conference

By C. L. King, F.C.A.
Executive Secretary, C.I.C.A.

Triumph of the new look!

THE 52nd Annual Meeting of the Canadian Institute of Chartered Accountants, held in Winnipeg from August 23 to 26, was a definite success. There is no doubt that a canvass of the 800 persons who took part in the technical sessions and social functions would heartily confirm this fact. The host Institute — The Institute of Chartered Accountants of Manitoba — made the warmth of its hospitality abundantly evident and the three days of technical sessions with their high calibre speakers and the interest shown by their audiences were highly satisfactory.

Members of the Executive and the Committee on Education and Examinations met at Kenora and Minaki respectively on August 20 and 21. The Council of the Canadian Institute met in Winnipeg in morning and afternoon sessions from August 23 to 26.

In line with the decision made by Council in 1953, this year's technical program was on a considerably larger scale than in previous years. It was designed to interest members in public practice, industry, and government service. A random survey of some of the subjects chosen for discussion will indicate their variety: "Conducting an Auditing Practice To-day and To-morrow"; "Financial Management in Industry"; "Preparation of the Annual Report to Shareholders"; "Taxation Problems on Purchase or Sale of a Business"; "Governmental Appropriation Accounting"; "Financial Controls Over Materials"; "Taxation and Accounting Principles"; "Internal Reports to Management".

Luncheon and dinner addresses numbered two this year. Mr. Philip Chester, A.C.A., Managing Director of the Hudson's Bay Company, spoke at the opening luncheon for members on August 23. His talk "The Other Side of the Fence" covered his impressions on the development of the profession since the first world war and some suggestions as to its future role. The Government of Manitoba was host at a luncheon at the Fort Garry Hotel on the following day when the Honourable R. D. Turner, Provincial Treasurer and Minister of Industry and Commerce, delivered an address dealing with western Canada's opportunities and those of Manitoba in particular.

On August 25, when all technical sessions were held at the University of Manitoba campus, the Manitoba Institute was host at a luncheon in the uni-

versity dining room. Mr. Justice Paul DuVal, Chairman of the Board of Governors of the University, together with those who led the Convention's educational program, were guests at the head table.

The closing dinner on Thursday, August 26, which was preceded by a reception, was honoured by the presence of Lieutenant Governor The Honourable J. S. McDiarmid; Provincial Treasurer and Minister of Industry and Commerce Ronald D. Turner; Mr. Arthur B. Foye, President, The American Institute of Accountants; His Worship Mayor Garnet Coulter; and Mr. John A. MacAulay, President, The Canadian Bar Association. Approximately 500 were present including members' ladies and the wives of official guests.

An unusual feature of this year's dinner was the setting up of three head tables in T-formation seating 98 persons, enabling the Institute to recognize many of those who had contributed to the success of the convention. The gathering was presided over by retiring president Walter J. Macdonald who introduced honoured guests and spoke briefly on his year of office. His announcement of the establishment of a governor-general's gold medal was received with applause by the large gathering.

Mr. Foye extended the good wishes of The American Institute of Accountants. Speaking of unity he suggested that ways should be found to promote the idea of united thinking on the part of each Institute. Towards the end of the evening the new President, J. Grant Glassco, was introduced to the audience. He thanked those who had been responsible for electing him to office and spoke of the great contribution made by his predecessor to the advancement of the profession. Enthusiastically acclaimed by all who watched, the President presented Walter J. Macdonald with a rawhide travelling bag. It was singularly appropriate that the Chairman of the Committee on Arrangements, Mr. James W. Abbott, should play his part in the proceedings. He presented to the newly-elected president a miniature, inlaid walnut door, suitably inscribed, extending to him, as representative of all Canadian chartered accountants, the "open door" to traditional western hospitality. Beautiful bouquets were also given to Mrs. Walter Macdonald, Mrs. Grant Glassco, and Mrs. Daniel Sprague, wife of the president of the Manitoba Institute of Chartered Accountants.

During dinner, guests were entertained by a local quartette, the Wildwood Clippers, and the evening concluded with two hours of dancing in the ball room.

Ladies' Program

While the technical sessions and members' luncheons progressed, the ladies were able to enjoy a variety of programs arranged specially for them. On Monday August 23 Mrs. Daniel Sprague, wife of the President of the Manitoba Institute, entertained at a coffee party at her home. On Tuesday August 24 the City of Winnipeg was host at a luncheon at the Royal Alexandra Hotel which was presided over by Mayor Garnet Coulter. Mrs. Walter Macdonald extended thanks on behalf of the guests. After the luncheon there was a sight-seeing motor tour of the city which included the Parliament Buildings, topped by the famous "Golden Boy", followed by the residential area of Wildwood Park and out to the beautiful campus of the University of Manitoba. Assiniboine Park was also on the itinerary and the tour continued through the industrial area and back through the downtown district before returning to the Fort Garry Hotel.

On Wednesday August 25 the ladies enjoyed tea at Lower Fort Garry and on Thursday August 26 visited St. Charles Country Club for luncheon.

Golf Competition

A number of members took part in the annual golf competition, facilities being provided at the St. Charles Country Club and the Niakwa Country Club. The Richardson Trophy was won by the Manitoba Institute for the low team score and the Thompson Trophy by Mr. J. M. Fowlis of the Manitoba Institute for the low net.

Social Evening

An informal social evening for members and their ladies was held on Tuesday August 24 at the Rancho Don Carlos. Accommodation was limited to 400 persons so that unfortunately the number who desired tickets was slightly in excess of the seating available.

Entertainment was provided by the piano playing of artist Carmen Cavallaro and an excellent buffet supper was served during the evening.

Any concluding remarks about the 1954 annual meeting would be lacking without paying a special tribute to the work of the organizers. Those who attended will long remember the spontaneous warmth of hospitality, and the high quality of the speakers taking part in the technical sessions. Their addresses which appear in the magazine will certainly bear out the opinion that the Canadian Institute has taken a decided forward step in the reorganization of its annual meeting program.

Professional Notes

ALBERTA

Riddell, Stead, Graham & Hutchison, Chartered Accountants, announce the admission to partnership of Mr Jack E. Baker, B.Com., C.A. who will conduct the practice of the firm in Edmonton with offices in the Royal Trust Bldg., 10039 Jasper Ave.

* * *

Peat, Marwick, Mitchell & Co., Chartered Accountants, announce the admission to partnership in their Edmonton office of Mr James C. Thompson, Jr., B.Com., C.A.

BRITISH COLUMBIA

P. S. Ross & Sons, Chartered Accountants, and Watson, Ewing & Rumball, Chartered Accountants, announce the merging of their practices. The combined practices in Vancouver will be carried on under the firm name of P.S. Ross & Sons, with offices at 744 W. Hastings St. Resident partners will be Messrs Robert Bell, F.C.A., Ian H. Bell, C.A., John B. Ewing, C.A., and Dale L. Rumball, C.A.

MANITOBA

Manitoba Students' Society

Members of the Chartered Accountants Students' Society of Manitoba have chosen R. L. (Bob) Wickett, a fifth-year student, as their president for the year 1954-1955. Mr. Wickett takes over the office from R. G. McEwen who held the position for the past year.

Elected to Council of the society by acclamation were Bruce Smith, Neil Buchanan, Stan Reid, Stan Puchniak, Ron Scott, Joe Myles, and Ian Plant. Other members of Council whose terms of office did not expire this year are Sam Martin, Jack Fyles, Herman Crewson, and Bonne Lemon.

The Society, which is an associate faculty of the University of Manitoba, had a very active year. Besides sponsoring numerous social activities and arranging sports events, it took part in Freshie Week activities, published a year book, and issued a regular news letter to students.

ONTARIO

Williamson, Shiach, Sales, Gibson & Middleton, Chartered Accountants, announce the removal of their offices to 133 Richmond St. W., Toronto.

* * *

Messrs Geoffrey H. Ward, C.A. and Herbert A. Watson, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Ward & Watson, Chartered Accountants, with offices at 6 William St. N., Lindsay.

* * *

Mr Ward and Mr William B. Buckley, B.Com., C.A. continue their practice under the firm name Ward, Buckley & Co., Chartered Accountants, 28 Duke St., Toronto.

C.A. Club of Western Ontario

The Chartered Accountants Club of Western Ontario held their annual golf tournament at Sunningdale Golf Club, London on September 26. The inter-office trophy was won by William C. Benson & Co. with a team average of 114.4.

QUEBEC

Mr Jean-Paul Bolduc, C.A. announces the admission to partnership of Mr Jules Lavoie, C.A. Practice of the profession will be carried on under the firm name of Jean-Paul Bolduc & Cie, Chartered Accountants, with offices at 81 St. Peter St., Quebec.

* * *

Messrs Jacques Gingras, c.a., Yves Normandeau, c.a., Paul Gingras, c.a., et Donald Fortier, c.a. annoncent qu'ils pratiquent maintenant leur profession sous la raison sociale de Gingras, Normandeau, Fortier & Cie, comptables agréés, 293 blvd Charest, Québec.

SASKATCHEWAN

Regina C.A. Club

On September 21 the Regina Chartered Accountants Club held their first meeting of the 1954-55 season. The executive elected is as follows: *president,* Lloyd O. Robinson; *secretary,* J. Smith; *directors,* C. Westerman, H. Rendall, W. E. Clarke.

News of Our Members

Mr E. C. Stilling, C.A. (Alta.), has been appointed chief accountant for Shell Oil Company, Calgary Area.

* * *

Mr A. J. Hamilton, C.A. (Alta.), addressed a meeting of the Society of Industrial and Cost Accountants of Alberta on "Double Taxation of Corporations".

Mr E. H. Ambrose, C.A. (Ont.), is this year's chairman of the Red Feather Campaign in the city of Hamilton, Ont.

* * *

Mr Paul Hickey, C.A. (Ont.), has been appointed treasurer and commissioner of finance of the Corporation of the City of Hamilton.

Supplement to Research Bulletin No. 6

THE AUDITOR'S REPORT

Issued by the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants, September 1954

Changes in Ontario Legislation Affecting the Auditor's Report

SINCE Bulletin No. 6 was issued in September 1951, the Legislature of the Province of Ontario has enacted a new Companies Act, The Corporations Act, 1953, which has wide application because of the large number of companies incorporated under Ontario legislation. The requirements of this new Act relating to the disclosure of information in annual financial statements go considerably beyond those of the previous Ontario Act and The Companies Act (Canada); the requirements relating to auditors and their reports have also been revised and clarified.

The provisions relating to the auditor's examination and his report have been considered by the committee and, later in this bulletin, a form of report is recommended which, in the opinion of the committee, conforms to the new requirements.

Subsections (1), (2) and 3) of section 82 relating to the auditor's report read as follows:

82(1) The auditor shall make such examination as will enable him to report to the shareholders as required under subsection 2.

(2) The auditor shall make a report to the shareholders on the financial statement to be laid before the company at any annual meeting during his term of office and shall state in his report whether in his opinion the financial statement referred to therein presents fairly the financial position of the company and the results of its operations for the period under review.

(3) The auditor in his report shall make such statements as he considers necessary.

(*a*) if the company's financial statement is not in agreement with the accounting records;

(*b*) if the company's financial statement is not in accordance with the requirements of this Act;

(*c*) if he has not received all the information and explanations that he has required; or

(*d*) if proper accounting records have not been kept, so far as appears from his examination.

In Bulletin No. 6 this committee stated that "an opinion of an independent accountant upon financial statements is given only after an examination of such a nature and scope as will justify the expression of an opinion". Under the Ontario Act, the auditor is now specifically charged with the responsibility of making such an examination. Also in Bulletin No. 6 this committee stated that "the auditor should express in his report his opinion of the statement of profit and loss and surplus as well as of the balance sheet". This is now a statutory requirement where The Corporations Act (Ontario) applies.

Whereas formerly the Ontario Act required the auditor to state in his report whether or not all his requirements as auditor had been complied with and whether the balance sheet was as shown by the books, he is now

required so to report only under the circumstances described in s. 82(3).

Recommended Form of Auditor's Report Under the Corporations Act, 1953, (Ontario)

When the auditor is reporting under section 82 of The Corporations Act, (Ontario) upon the financial statements of a company and is in a position to express an unqualified opinion, it is recommended that his report take the following form:

AUDITOR'S REPORT[1]

To the Shareholders of

..Company Limited:

I have examined the balance sheet of..
Company Limited as at....................................19............and the statement of profit and loss and surplus for the year ended on that date. My examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as I considered necessary in the circumstances.

In my opinion the accompanying balance sheet and statements of profit and loss and surplus present fairly the financial position of the company as at..19........ and the results of its operations for the year ended on that date.

(Signed)..

Chartered Accountant

This form of report, with any necessary modifications, may also be appropriate in reporting upon the financial statements of partnerships, sole proprietorships and associations.

Consistency in Application of Accounting Principles

The form of the auditor's report recommended in Bulletin No. 6 and the form recommended in this supplement do not include reference to consistency in the application of accounting principles. However, Bulletin No. 1 (and section 87(1) of The Corporations Act, (Ontario)) requires disclosure of any important change in the company's accounting procedures which has had a material effect on the profits and losses as reported, the nature thereof and, if practicable, the effect of such change. Accordingly, in the absence of disclosure to the contrary, consistency in the application of accounting principles from year to year is implied.

1 The committee believes it desirable that the financial statements indicate the statute under which the company is incorporated. If this is not done, it may be thought desirable to disclose in the auditor's report the statute under which the audit has been conducted.

Accounting Research

By Gertrude Mulcahy, B.A., C.A.
The C.I.C.A. Research Department

INVESTMENTS IN SUBSIDIARY COMPANIES

A GREAT many companies carry out some of their operations through subsidiary companies. Of the 280 annual reports reviewed for 1952,* 177 revealed that the company held control of the majority of the voting stock of other companies (1951 — 176 of 279; 1950 — 150 of 209; 1949 — 141 of 202). Such disclosure was made in 139 cases by the presentation of the financial statements on a consolidated basis and in 37 cases by the inclusion in the balance sheet of investments in subsidiary companies. However, in one financial report the investment in the subsidiary company mentioned in the directors' report was included on the balance sheet under the "Investment" caption as ". . . . Ltd. Shares at Cost". Although the directors' report set out the amount of the net profit of the subsidiary company, no indication was given in the annual report as to the accounting treatment followed in respect of such profit. Of the 139 consolidated statements, 98 were prepared on the basis of consolidating all subsidiary companies. In the remaining 41 cases, only some of the subsidiary companies were consolidated, the investment in the non-consolidated subsidiary companies being shown as a separate item on the balance sheet. With the 37 cases mentioned above this made a total of 78 companies showing investment in subsidiaries as assets.

Basis of Valuation

In Bulletin No. 1 the Committee on Accounting and Auditing Research recommended that the basis of valuation of the investment in subsidiary companies should be indicated in the financial statements. In this respect, 42% of the 78 financial statements, which showed investment in subsidiary companies outstanding as at the 1952 year end date, stated that "cost" was the basis used in valuing this item (1951 — 40%; 1950 — 35%; 1949 — 36%). An additional 16% described the basis of valuation by the use of terms such as: cost less reserve, cost less write off, not more than cost, revalued by management in 19—, less reserve, book value less reserve, and value which in aggregate is less than cost. Some of these miscellaneous descriptions can hardly be classified as a true indication of a basis of valuation but rather as a hint of what the basis might be. The remaining 42% of the 1952 financial reports concerned made no mention of the basis upon which the investment in subsidiary companies was included in the parent company's accounts

* Of these, 182 came from companies whose reports had also been included in each of the 1949, 1950, and 1951 analyses.

(1951, 47%; 1950, 47%; 1949, 40%).

Only 14 of the 1952 reports contained a reference to or disclosure of the parent company's equity in the subsidiary companies.

Segregation of Advance to and Investment in Subsidiary Companies

Figure 1 summarizes the methods used by Canadian companies to distinguish between the investment in shares of and the advances to subsidiary companies. In the majority of cases in which these items were grouped and extended as one figure on the balance sheet, the relative significance of the total investment to the overall financial picture did not warrant the disclosure of the amounts attributable to the components.

Accounting Treatment Re Profit and Loss

Bulletin No. 1 contains the recommendation that "Unless a consolidated balance sheet is presented the accounting practice followed with respect to profits or losses of subsidiaries should be stated". Disclosure of this information was made in the 1952 annual reports as follows:

49	— referred to in auditor's report
13	— set out in notes attached to financial statements
1	— referred to in directors' report
63	

Fifteen of the annual reports for 1952 did not disclose the accounting treatment followed in respect of such profit and loss in the parent company's accounts. In the case of one company, incorporated under the Companies Act (Canada), such procedure was justified in that the balance sheet clearly stated that the subsidiary company was a non-operating company. The remaining 14 companies were incorporated under provincial statutes which did not require any such disclosure. Three of these set out, as a separate item in the statement of profit and loss, dividends received from subsidiary companies.

Although most of the annual reports contain a reference to the accounting treatment of subsidiary companies' profits and losses, the reader is sometimes left to his own resources to determine the exact procedures followed in this respect. For example, the auditors of one company stated that "In accordance with section 114 of The Companies Act, Canada, we report that the net loss of the wholly-owned subsidiary company which is not consolidated (. . . . . Limited) for its last fiscal year has been fully provided for in the accompanying statements." There is no reference either in the financial statements or in the directors' report as to how such loss has been provided for in the parent company's accounts. The disclosure on the 1952 balance sheet that the investment in the wholly-owned subsidiary company is valued at "cost less

Figure 1

Balance Sheet Segregation of Advances to and Investment in Subsidiary Companies

1952	1951	1950	1949	
53%	49%	45%	50%	— Separate figures
1%	1%			— Grouped in one figure with amount of advances set out in description.
4%	7%	12%	14%	— Grouped in one figure
42%	43%	43%	36%	— No indication of advances
100%	100%	100%	100%	

reserve of $5,000", as in 1951, might be taken to imply that no adjustment has been made in this account to provide for the subsidiary losses. However, a comparison of the 1951 and 1952 financial statements reveals that although the stated basis of valuation is unchanged, there has been a reduction of $1,513 in the amount of this item which could or could not result from providing for the loss of the subsidiary. Fortunately, in this particular instance the lack of precise information as to the accounting procedures adopted is not too significant because the amounts involved are immaterial.

Examples

The excerpts shown below have been selected from the annual reports analyzed for 1952 to indicate some of the methods used by Canadian companies to disclose information relating to the investment in non-consolidated subsidiary companies.

The total of the investment in non-consolidated subsidiary companies in example 1 represents approximately 24% of the assets of the company other than current assets. The amounts of the components of this figure, investment in stocks and advances, have been set out separately on the balance sheet under a properly descriptive caption. The basis of valuation of the investments in stocks of subsidiary companies has been set out on the balance sheet. The auditor's report disclosed that the parent company has followed the practice of taking into its accounts only that portion of the profits of non-consolidated subsidiary companies which has been received as dividends. The amount of such dividends is set out as a separate item in the statement of profit and loss. The amount of the increase of the parent company's equity in the non-consolidated subsidiary companies since acquisition, the amount of the parent company's equity in the current profits less losses of these companies, and the amount of dividends received therefrom are all set out clearly in the note annexed to the balance sheet. The disclosure of the amount applicable to the subsidiary companies in various countries is of particular significance in light of existing exchange regulations. The management of this company has been successful in its endeavour to present to the reader information which will be of assistance in determining the relative significance of the non-consolidated subsidiary companies in the overall financial picture. This presentation does, in effect, embody the recommendations expressed by the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants in Bulletin No. 1.

There should be no doubt in the mind of anyone who reads example 2 that it is the practice of the management of the parent company to take up in its accounts its share of the profits and losses of the non-consolidated subsidiary company. The description of the basis of valuation of the balance sheet item "Investment in and Advances to Subsidiary Company", the auditors' disclosure under section 114 of the Companies' Act (Canada), and the disclosure of the parent company's share of the current loss of the subsidiary company in the statement of deficit account clearly indicate how such net losses have been reflected in the parent company's accounts. The grouping of the investment in shares and advances to subsidiary companies in example 2 might arouse some criticism. However, in view of the fact that the assets, other than current, totalled $2,-242,200, a break down of this item of $6,042 would add nothing to the overall picture. The segregation of the total investment under a properly descriptive caption could not possibly be interpreted as an indication that this item is considered to be of significance. Such presentation was obviously adopted by the man-

agement in order to eliminate the grouping of what they considered to be dissimilar items.

The term "fixed assets" generally refers to tangible items such as land, buildings, machinery, and equipment. As a result, the balance sheet classification of the "Investments in subsidiary companies" as a fixed asset, in example 3, might cause some confusion to a casual reader, but in view of the fact that such investments represent less than 1% of the total assets other than current, they do not warrant a separate balance sheet classification. The assets of the company have been set out under three general headings: "Current Assets", "Deferred Charges", and "Fixed Assets". Under these circumstances the inclusion of such investments under the "Fixed Assets" caption is a reasonable presentation.

The segregation of the investments from the plants, buildings, equipment, etc., and the extension of two figures under this category , indicates to the reader that management recognizes certain dissimilarities between the items included. Unlike examples 1 and 2, there is no disclosure in the financial report of the basis of valuation on which such investments are incorporated in the financial statement.

As in examples 1 and 2 the auditor states in his report the practice followed by the parent company in respect to the profits and loss of the subsidiary companies. However, in complete contrast to examples 1 and 2 there is no disclosure in the financial report of the amount thereof which has been taken into the parent company's accounts in the current year. The dividends received from subsidiary companies are obviously included in the item "Income from Investments" appearing in the income statement. Although the directors disclose the amount of the parent company's equity in the current undistributed profits of the subsidiaries, no reference is made to the increase or decrease in the parent company's equity in its subsidiary companies since acquisition. The reason for the reference by the directors to the total assets of the subsidiary companies as at the year end date is not apparent.

EXCERPTS FROM PUBLISHED FINANCIAL REPORTS — 1952

Investment in Subsidiary Companies

Example 1

In balance sheet

ASSETS

INVESTMENTS IN AND ADVANCES TO SUBSIDIARY COMPANIES NOT CONSOLIDATED (NOTE 5):

Capital stocks, at cost	$ 3,836,480	
Advances	12,933,031	
		16,769,511

Note 5: Investments in and advances to subsidiary companies not consolidated comprise $8,082,000 for subsidiaries in Scotland and Jamaica, B.W.I., $1,318,000 for subsidiaries in Canada and $7,370,000 for subsidiaries in the United States. The equity in the net tangible assets of these companies, as shown by their balance sheets, is approximately $2,800,000 in excess of the amount at which the investments and advances are included in the attached accounts. The equity in the profits less losses of these com-

panies for the year, as shown by their income accounts, amounted to approximately $490,000: dividends of $24,250 were received during the year.

(Total assets, other than current — $69,416,030)

In statement of profit and loss

Dividends from subsidiary company not consolidated $24,250

(Reported profit transferred to earned surplus — $37,283,535)

In auditor's report

In accordance with the requirements of Section 114 of The Companies Act, 1934, we report that the profits for the year of the subsidiary companies not consolidated have been included in the consolidated accounts to the extent of dividends received and that the Corporation's equity in the aggregate profits less losses of those subsidiaries exceeded the amount of such dividends.

Example 2

In balance sheet

ASSETS

INVESTMENT IN AND ADVANCES TO SUBSIDIARY COMPANY:

....Limited:

Shares, at cost, and advances less losses (net) incurred to date	$6,042

(Total assets, other than current — $2,242,200)

In statement of deficit account

Deduct:

Loss incurred in 1952 by subsidiary, ...Limited	$ 466

(Reported loss transferred to deficit account — $482,493)

In auditor's report

In accordance with Section 114 of the Dominion Companies Act we report that the accumulated net losses incurred by the subsidiary company have been reflected in a reduction of the book value of the holding company's investment in shares of and advances to the subsidiary, the relative net charges having been made to the holding company's surplus account.

Example 3

In balance sheet

ASSETS

CURRENT ASSETS		
Accounts receivable, less reserve for doubtful accounts		$ 14,644,241
Customers	$13,844,429	
Subsidiary companies	215,133	
Other accounts	584,679	
FIXED ASSETS		
Plants, buildings and equipment*	96,871,750	
Land, at cost	2,715,340	
Goodwill, patents and processes	3,377,151	$102,964,241
Investments in subsidiary companies	984,533	
Shares in other companies	200,000	1,184,533

LIABILITIES

CURRENT LIABILITIES

Accounts payable	$11,793,276	
Subsidiary companies	64,815	
		$ 11,858,091
Federal, provincial and municipal taxes		$ 7,263,834
Dividends declared		2,905,007
		22,026,932

(Total assets, other than current — $104,920,165)

* The details of the basis of valuation presented in the financial statement in respect of plants, buildings, and equipment have been deleted for purposes of this example.

In auditor's report

In accordance with Section 114 of The Companies Act, 1934, we report that the Company's share of the aggregate profits earned by subsidiary companies for the year 1952 has been included in the attached accounts only to the extent of the dividends declared and received by the Company.

In directors' report

As in previous years, the profits of subsidiary companies have not been consolidated with those of .... Limited, but have been included in the Company's financial statements only to the extent of the dividends declared and received by the Company. All subsidiary companies earned profits in 1952, the total of which exceeded the sum of cash dividends declared. The Company has an equity of $19,000 in these undistributed profits. At 31st December 1952, the total assets of the subsidiary companies were equivalent to about 4 per cent of the assets of .... Limited.

Practitioners' Forum

Conducted by Geoffrey H. Ward, C.A.

BUILDING YOUR CLIENTELE

WOULD you like to have lots of new clients, build a larger practice? Are you contemplating starting in practice on your own? Would you like to know how to get clients? While we don't have any infallible recipe, one of your panel members, Mr. D. A. Ross, C.A. of Calgary, prepared a good list for you to start on. Here, supplemented by comments from other panel members, is his list.

1. FROM EXISTING CLIENTS

Probably the best way to increase volume is to have satisfied clients. This can build your practice in three ways —

(a) Expansion of present clients' business interest

Keep in touch with any new moves your clients plan to make. The requirements of our Professional Code do not allow you to ask a client to give you all his work where he is already using more than one firm of auditors. However, when a client acquires another business even though it has been audited by another accountant, it is quite normal and natural for you to expect to be requested to undertake that audit too. Under most circumstances, if you did not get the appointment this would indicate that you were not on very solid ground insofar as that client was concerned. From the client's point of view there are very distinct advantages to having all his financial affairs under the review of one accountant. Indeed proper tax advice can hardly be rendered today without full knowledge of all a client's business activities. If you regard your present assignments as more than just a job of work and show proper interest in each client's affairs, your work for a client will expand as his interests expand.

(b) Expansion of services rendered to clients

Every client has different needs, hence you should be constantly on the lookout for additional services that you can provide. One panel member feels that this important source of work is one of the most neglected, especially in practices that have a reasonable number of clients. There is often much valuable tax service to be rendered where present services are mainly of an audit nature, and where present assignments are largely tax, there is the possibility of audit work. Where only annual financial statements have been prepared there is often a need for interim statements and sometimes a need for special

purpose statements. Where a client's accounting staff is over-burdened, or in a smaller business where the accountant's ability and experience are more limited, the client may be willing to turn over certain accounting work to you. This may include the preparation of government reports, special reports, insurance claims, indeed any work that is unusual or non-recurring or in some way apart from the normal accounting routine. Perhaps an accounting system needs revision or there is a need for advice on financial matters. Let your clients know that a full professional service is available to them. You should be sufficiently close to your clients' businesses to know their needs and to be aware of the possibilities for special services. Special assignments often make the client more appreciative of your services than regular audit work.

(c) Recommendations by clients

Your best advertisement is always a satisfied client. Tell your clients how valuable their good opinion is to you. Be sure to promptly acknowledge any recommendations they may make.

2. FROM OUT-OF-TOWN CONTACTS

Build up your out-of-town contacts. Through them you may be able to make connections with businesses moving into your community. You may be able to build some volume from branch work performed for out-of-town firms. Contacts can be built by taking an active part in Institute affairs and thereby becoming better known to fellow members practising in other cities. They can also be built by taking an active part in trade and service organizations that operate on a provincial or wider basis. Your geographical position has a great deal to do with the importance of out-of-town contacts. If you are located in one of our main cities you may find it helpful to work out an arrangement with accountants located in other main cities. If you are located in a large city you may find it helpful to do work for accountants practising in smaller centres in your Province or vice versa. Some cities are linked closely with others and are served in many instances by the same businesses. In these circumstances if you cannot operate branches in the related cities, you will find it helpful to have working arrangements with practising accountants instead.

3. FROM THE LEGAL PROFESSION

Many recommendations as auditor for new incorporations may be obtained from lawyers. In addition legal firms frequently require accountants for investigation work and as expert witnesses. Many small businessmen who have never used the services of a professional accountant go to a lawyer to consult him about incorporating, about tax problems, about their wills, or about legal agreements that require accounting information. Hence their opportunities to recommend to clients the services of a professional accountant are numerous. In this country each year lawyers and accountants are working closer together and lawyers appreciate the special services that can be rendered by competent professional accountants. They will recommend an accountant they know and one in whom they have confidence. This prompts two suggestions: take full use of any opportunity to get on closer terms with lawyers and see that in your professional dealings with them you build their confidence in your abilities.

4. FROM FINANCIAL CONCERNS

Financial houses and banks frequently require audit or special investigation work prior to investment or to loaning funds. In Canada, where there are only a few banks, the professional status of the chartered accountant is well recognized. The banker seeks reliable infor-

mation and will have no hesitancy in forcefully recommending to the borrowing businessman that he present him with audited statements. Even where the businessman is not borrowing from the bank, he uses his banker as a business consultant and will ask his advice when seeking an auditor. It helps to be personally known to bankers in your community. It helps to write the kind of report that gives the banker the information he considers important. It helps even more for them to have a high opinion of your professional competence and reliability. This column dealt with relations between the public accountant and the banker in the May and July 1954 issues.

5. FROM A GENERAL KNOWLEDGE OF NEW AND CHANGING BUSINESS IN YOUR COMMUNITY

In the smaller towns you may be able to keep a running check on business changes, new incorporations, and law suits. From a detailed study of such information you may be able to spot new sources of business. Also you may be able to ascertain where business that you had expected was directed.

6. FROM THE DEVELOPMENT OF STAFF SPECIALTIES

In addition to our primary function as auditors the main specialty of the public accountant today is probably as a tax expert. However, you may find that the development of other specialties will, when recognized, increase volume. Many accountants are licensed trustees in bankruptcy. This may well increase your business in depressed times. There is a growing trend towards becoming financial advisers to management. This role may in a few years exceed tax advice in importance.

7. FROM HAVING A STAFF SURPLUS

A reserve capacity in staff hours will permit you to take on new work or special engagements without disrupting existing work, and accordingly will encourage the influx of new business. New work is often dependent upon the ability to give immediate service. A prospective client may have had two or more auditors recommended and may have to choose one who can give immediate service. A client may have work done by his own staff that he preferred to have done by you.

8. FROM CONTACT FOLLOW-UP

A complete record should be kept of every new prospect. You should recontact him at intervals until his work has been taken care of.

Other methods include the purchase of a practice, a merger, or an agreement for succession. However, as these are major topics comment on them is being saved for later.

* * *

SOME further comments on this same topic appeared in *The Journal of Accountancy* for October 1953. Dixon Fagerberg, Jr., C.P.A. in an article "Building and Keeping a Clientele Requires Basic Analysis and Military Tactics" covered some interesting points. He suggests that successful accounting practices don't just happen — they result from careful planning based on intelligent thinking. A rational businesslike approach to the task of building a practice following the concept of investment and yield, and the techniques of salesmanship, is appropriate. Particularly important, he says, is knowing what product is being marketed and then improving it continually.

You have to "get there first with the most" and this implies frontiers to be penetrated. In public accounting the three frontiers comprise the geographical, the intensive cultivation of clients already being served, and new services.

Now to consider each of these in turn.

The location should be chosen after a proper survey of the potential market. Assuming that 1,000 people are needed to support one person in public accounting and that the potential gross revenue from all sources is about $5 per capita, a town of 5,000 should ultimately make possible a practice consisting of one principal, three other accountants, and a secretary-typist, with an annual gross of $25,000.

In order to make a good start in the intensive cultivation of clients the author feels that the only way to cement a lasting relationship is to see to it that the value of the work to the client exceeds the cost to the accounting firm, by as much as the firm can possibly afford. This point is particularly applicable to public accounting, because repeat engagements are the lifeblood of a healthy practice. The same economic laws apply to accounting as to other businesses. Those who succeed and grow are those who put out the most value. The strategic time to establish such a reputation with clients is at the start of the engagement. The return on this investment of time comes when the client tells his friends and associates that a C.A.'s work does not cost; it pays.

"Getting there first with the most" raises the question "the most of what". What we are selling — time, experience, education, financial statements, reports, audit certificates? Our end product is actually useful information, that is, information which has been interpreted so that the reader may make use of it. Mr. Fagerberg makes the point that whilst with big companies it is the president who writes the annual report, with smaller companies there is an opportunity for the auditor in his long-form report to convey the story of the financial operations for the year and to point out the messages to be learned from the financial statements.

Now let us assume that we have arrived, that we have established our accounting practice and built the necessary volume. As is clearly evident in the case of military advances, it is ncessary for us to consolidate and regroup before advancing further. If we do not do so, poor administration can ruin a successful practice. Experience in retaining clientele after it has been built fortifies the view that administration is what cleans, overhauls, and lubricates the productive machinery. Sound organization and planning must be given proper status to maintain production and quality of the professional product.

In conclusion, here are a couple of provocative quotes from Mr. Fagerberg's article: "Running your own office efficiently is always the most productive engagement on the list". "It is normal and healthy to lose clients occasionally— undesirable clients. No firm can do all the accounting in the world, so salvation lies in just doing the best of it."

The editor of this bi-monthly column cordially invites correspondence from his readers.

The Students' Department

J. E. Smyth, C.A., Editor

(*Correspondence with the editor is cordially invited.*)

NOTES AND COMMENTS

Can Next Year's Depreciation Expense be a Current Asset?

WE are all familiar with the reasoning by which a long-term liability is classified at last as a current liability at the year-end preceding its maturity — provided, at any rate, it is neither going to be refunded nor paid out of "sinking fund" assets which are not themselves classified as current assets. A long-term liability is, as it were, kicked upstairs just before it is retired.

But now a student has raised an interesting point. If this reasoning applies to long-term *liabilities,* why does it not also apply to long-term (i.e. fixed) *assets?* If it does, then next year's depreciation expense should be classified as this year-end's current asset!

There is, in fact, quite a bit to be said for such reasoning, though we must admit we do not expect the people who prepare balance sheets to be readily converted. In support of the student who has raised the point, we submit that it is quite proper to regard fixed assets as a bundle, or package, of services which will become available to the business over an extended period of time; services which will be gradually sold to customers, along with all the other goods and services purchased by the business. In this rather subtle way the cost of fixed assets is eventually realized in part or in whole by a business through its revenue. Depreciation expense may be defined, therefore, as the cost of those services provided by fixed assets which, it is estimated, have been sold to customers in the current year. As for next year's depreciation expense, it will be realized in a similar way next year.

What then, one may well ask, is the difference between that portion of the cost of fixed assets which will be realized in revenue in the following year, and the cost of inventories, and prepaid expenses in general, which will be realized in a similar way? If inventories and other prepaid expenses are to be classified as current assets, why not also next year's depreciation expense?

This is, indeed, an awkward question. While readers are pondering it they may, if they wish, keep their morale up by picturing us trying to solve this month's puzzle (see below) while awaiting the answer.

* * * *

Assuming the above reasoning to be given effect in a balance sheet, the relevant sections of the balance sheet might appear:

Current assets

Cash on hand and in bank		$xxx	
Accounts receivable	$xxx		
Less allowance for doubtful accounts	xxx		
		xxx	
Merchandise inventory, at cost		xxx	
Prepaid expenses (depreciation, insurance, office supplies)		xxx	
Total current assets			$xxx

Long-term assets

Plant and equipment, at cost	xxx	
Less recorded depreciation to date	xxx	
Unexpired cost to date	xxx	
Less portion of unexpired cost awaiting realization next year (shown as depreciation in the current asset section, above)	xxx	
Total long-term assets		xxx
		$xxx

PUZZLE

The following situation arose in actual litigation. In order to prepare exhibits for use by the defence in court it was necessary to examine the plaintiff's records which were made available to me by court order. On examination, many of the most pertinent figures were found to be expressed in code. Only part of the books were covered by the court order, since the majority did not pertain to the case; it was therefore impossible to determine the wanted amounts by accounting formulae. It was not expedient to obtain the plaintiff's explanation of the key to his code; such explanation could not have been accepted without independent proof even if it were available. Finally, any solution would have to be demonstrated as correct beyond doubt, to the satisfaction of the jury.

Fortunately, the following example of the use of the code appeared on one page of the books available to me; in every other instance it was used for single figures only:

```
 R A, J B B. S J
 A M, W O S. B R
 ---------------
 W B, J S A. J O
    A, E W A. R W
    B, R A R. O B
    B, R A R. O B
 ---------------
 J J A, J N N. B W
```

What numbers did the various letters represent? (Every letter represents a different digit.)

(Submitted by Mr. E. R. Raper, Dallas, Texas)

SOLUTION TO THE OCTOBER PUZZLE

When the band fits, its circumference $= 2\pi r_1$
where $r_1 =$ distance from the earth's core to its surface.

After 12 inches have been added, its circumference $= 2\pi r_2$

where r_2 = distance from the earth's core to the band.

But $c_2 - c_1 = 12$ inches.

Therefore,

$$(2\pi r_2) - (2\pi r_1) = 12 \text{ inches}$$
$$2\pi(r_2 - r_1) = 12$$
$$r_2 - r_1 = \frac{12}{2\pi} = 12 \div 6.2832$$
$$r_2 - r_1 = \underline{\underline{1.91 \text{ inches}}}$$

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1953

Accounting II, Question 3 (20 marks)

CA has been approached by X, the new owner of a large business building, for advice concerning an accounting system which would properly account for rents received, rents receivable, and the gross rental revenue.

Required:

Outline an adequate system.

A SOLUTION

THE X BUSINESS BUILDING

ACCOUNTING SYSTEM RECOMMENDED TO RECORD RENTS RECEIVED, RENTS RECEIVABLE AND GROSS RENTAL REVENUE

Records to be maintained

1. A rental register, in either card or book form. This book will contain a separate sheet or card for each office, setting out the office number, space, rent, terms of rental, contract, and the name of the person presently occupying the suite.
2. Vacancy and occupancy notices. These notices will be prenumbered and contain space in which to record the details of all changes in occupancy, viz., the effective dates, the suite concerned, and the amount of the rental involved.
3. A rental receivable ledger. This is a subsidiary ledger containing individual accounts for each tenant, with the details of his name, suite occupied, and amount of rent, plus a separate account for unoccupied space.
4. Prenumbered duplicate cash receipt forms, to record all payments over the counter.
5. A cash receipts book with a separate column to cover receipts of rentals, "Cr. Rentals receivable".
6. A rentals receivable control account in the general ledger.

Operation of the System

1. At the beginning of every month a journal entry is prepared to record the total rental value of all space (whether occupied or not):

   Dr. Rentals receivable xxxx
   Cr. Rent revenue xxxx

   The amount is obtained from an adding machine tape of the cards or ledger sheets in the rental register.
2. The details of the rentals receivable are posted from the individual cards or sheets in the rental register to the respective accounts in the subsidiary ledger.
3. The vacancy and occupancy notices are the basis for entries in the rental register and in the rental receivable (subsidiary) ledger for the tenants affected. The adjustments of rentals as recorded on the notices will be posted directly to the special account for unoccupied space and the individual tenants' accounts in the rentals receivable ledger. The notices will be filed monthly.
4. At the end of every month the total rental value of unoccupied space, as shown in the rental receivable ledger, is recorded by a journal entry:

   Dr. Rent revenue xxxx
   Cr. Rentals receivable xxxx

   The credit side of the journal entry is posted to the general ledger account, "Rentals receivable control" and also to the account for unoccupied space in the subsidiary ledger, closing the latter account. The amount should agree with the total adjustments noted on the vacancy and occupation notices for the month. After the entry is posted, the monthly balance in Rent revenue account in the general ledger will be the gross revenue from actual space rented.
5. Cash received either through the mail or over the counter is recorded in the cash receipts book, setting out the name of the tenant and recording the amount in the "Cr Rentals receivable" column. The individual items are posted to the rental receivable ledger. The total of this column will record the actual rentals received.
6. The trial balance of the rental receivable ledger at the end of each month will be the total rental receivable as at that time.

Internal Control

1. Separate individuals must look after
   (a) maintenance of the rental register and the rental receivable ledger;
   (b) the vacancy and occupancy notices, including the necessary adjustments in rentals noted on them; and
   (c) cash receipts.
2. The trial balance of the rental receivable ledger should be scrutinized by X and arrears of rent investigated.

Examiner's Comments

Candidates revealed a lack of experience with the problem of devising a simple system. In particular, few candidates mentioned any division of labour.

PROBLEM 2

Final Examination, October 1953

Accounting III, Question 2 (22 marks)

In each of the following unrelated instances what eliminations and adjustments are necessary in the preparation of consolidated financial statements as at the fiscal year ended 30 June 1953?

(10 marks) (a)

On 1 July 1951 the X Co. Ltd. acquired 90% of the outstanding common shares of the Y Co. Ltd. for $600,000. The shareholders' equity in the Y Co. Ltd. as at 30 June 1951 was as follows:

Capital stock, surplus and reserves

Capital stock		
Authorized and issued—		
3,000 5% cumulative preferred shares par value $100 redeemable at $106	$300,000	
60,000 shares common — no par value	600,000	
Premium on issue of preferred shares	10,000	
		$ 910,000
Reserves:		
For contingencies	$ 25,000	
For future decline in inventory values	20,000	
For redemption of preferred shares	55,000	
		100,000
Surplus:		
Earned surplus	$100,000	
Distributable surplus	75,000	
		175,000
		$1,185,000

Preferred dividends are in arrears for the year ending 30 June 1951.

The following relate to the Y Co. Ltd. for the years ending 30 June 1952 and 1953:

(i) Net profit for years ending 30 June 1952 and 1953 were $65,000 and $80,000 respectively.

(ii) Dividends were declared and paid on preferred shares each year, together with arrears as at 30 June 1951.

(iii) Dividends of 65c per share were declared and paid to the common shareholders each year.

(iv) Appropriations totalling $35,000 were transferred from earned surplus to reserve for redemption of preferred shares in the 1952-53 year.

(v) The reserve for contingencies was no longer required and was restored to earned surplus in the 1952-53 year.

(vi) The reserve for future decline in inventory values was increased by $8,000 by appropriations from earned surplus in the 1951-52 year.

(12 marks) (b)

On 30 June 1952 the R. Co. Ltd. acquired 80% of the outstanding share capital of the S Co. Ltd. for $730,000. As at 30 June 1952, the capital of the S Co. Ltd. was $850,000 in no par value common shares and it had an accumulated earned surplus of $75,000.

On 1 July 1952 the T Co. Ltd. acquired 70% of the outstanding share capital of the R Co. Ltd. for $900,000. As at 1 July 1952, the capital of R. Co. Ltd. was $1,000,000 in no par value common shares, and it had an accumulated earned surplus of $250,000.

During 1952-53 the following inter-company sales of merchandise were made:

	Selling price	Gross profit on sale	On hand 30th June 1953 at cost to purchasing company
R. Co. Ltd. to T Co. Ltd.	$300,000	$ 60,000	$35,000
S Co. Ltd. to T Co. Ltd.	500,000	125,000	16,000
T Co. Ltd. to R Co. Ltd.	225,000	75,000	5,100

On 2 Feb 1953 the S Co. Ltd. resold a machine to the T Co. Ltd. for $234,000 which was 112.5% of its cost. Depreciation on machinery is provided by the companies on the straight line basis at 10% on the closing balances in the asset account.
Net profits for the year ended 30 June 1953 were as follows:

R Co. Ltd.	$120,000
S Co. Ltd.	90,000

No dividends were declared or paid during the year by either of the companies.

A SOLUTION

(a) X CO. LTD., AND ITS SUBSIDIARY Y CO. LTD.

ELIMINATIONS FOR CONSOLIDATED BALANCE SHEET — 30 JUN 1953

	Dr.	Cr.
Share capital common, Y Co. Ltd.	540,000	
Reserve for future decline in inventory values, Y Co. Ltd. (90% of 28,000)	25,200	
Reserve for redemption of preferred shares, Y Co. Ltd. (90% of 90,000)	81,000	
Premium on issue of preferred shares, Y Co. Ltd.	9,000	
Distributable surplus, Y Co. Ltd.	67,500	
Earned surplus, Y Co. Ltd. (90% of 49,000)	44,100	
Negative goodwill on consolidation		166,800
Investment in Y Co. Ltd.		600,000

To eliminate interest of X Co. Ltd. in capital and surplus of Y Co. Ltd. as of date of acquisition.

	Dr.	Cr.
Share capital, common, Y Co. Ltd.	60,000	
Premium on issue of preferred shares, Y Co. Ltd.	1,000	
Reserve for future decline in inventory values, Y Co. Ltd.	2,800	
Reserve for redemption of preferred shares, Y Co. Ltd.	9,000	
Distributable surplus, Y Co. Ltd.	7,500	
Earned surplus, Y Co. Ltd. (10% of 86,000)	8,600	
Minority interest in Y Co. Ltd.		88,900

Editor's notes:

1. The elimination of the parent company's share of the earned surplus of the subsidiary is calculated as follows:

Earned surplus Y Co. Ltd. 30 Jun 1951		$100,000
Deduct Required for arrears of preferred shares	$ 15,000	
Required as premium on redemption of preferred shares, 3,000 x $6	18,000	
		33,000
Earned surplus 30 Jun 1951 available for common shareholders		67,000
Deduct Portion of above surplus included in reserves at 30 Jun 1953:		
Reserve for redemption of preferred shares	35,000	
Reserve for future decline in inventory values	8,000	
		43,000
		24,000
Add Reserve for contingencies as of date of acquisition, subsequently transferred back to surplus		25,000
Surplus at date of acquisition available for common shareholders and classified as earned surplus at 30 Jun 1953		49,000
Parent company's share — 90%		$44,100

2. The minority interest in the earned surplus of the subsidiary at 30 Jun 1953 is calculated as follows:

Earned surplus Y Co. Ltd. 30 June 1951		$100,000
Add Profit for two years ended 30 Jun 1953		145,000
Transfer from reserve for contingencies		25,000
		270,000
Deduct Preferred dividends (3 years)	$ 45,000	
Common dividends (2 years)	78,000	
Transfer to reserve for redemption of preferred shares	35,000	
Increase in reserve for future decline in inventory values	8,000	
		166,000
Earned surplus Y Co. Ltd. 30 Jun 1953		104,000
Deduct Portion applicable to premium on redemption of preferred shares 3,000 shares at $6		18,000
Available for common shares		$ 86,000
Available for minority interest in common shares — 10%		$ 8,600

(b) T CO. LTD. AND ITS SUBSIDIARIES, R CO. LTD. AND S CO. LTD.
ELIMINATIONS FOR CONSOLIDATED STATEMENTS — 30 JUN 1953

		Dr.	Cr.
Share capital S Co. Ltd. (80% of 850,000)		680,000	
Earned surplus S Co. Ltd. (80% of 75,000)		60,000	
Share capital R Co. Ltd. (70% of 1,000,000)		700,000	
Earned surplus R Co. Ltd. (70% of 250,000)		175,000	
Goodwill		18,000	
Investment in S Co. Ltd.			730,000
Investment in R Co. Ltd.			900,000
Minority interest in R Co. Ltd.			3,000
To eliminate interest of R Co. Ltd. in capital and surplus of S Co. Ltd. and interest of T Co. Ltd. in capital and surplus of R Co. Ltd. The minority interest in R Co. Ltd. is adjusted for its share (30%) of negative goodwill in the purchase price paid by R Co. Ltd. for its interest in S Co. Ltd. Goodwill is calculated as follows:			
Price paid by T Co. Ltd. for controlling interest in R Co. Ltd. and S Co. Ltd.		900,000	
Deduct Equity acquired by T. Co. Ltd.			
70% of (1,250,000 — 730,000) =	364,000		
70% of 80% of 925,000 =	518,000		
		882,000	
Goodwill		18,000	
Share capital S Co. Ltd. (20% of 850,000)		170,000	
Earned surplus S Co. Ltd. (20% of (75,000 + 90,000))		33,000	
Minority interest in S Co. Ltd.			203,000
To set up minority interest in S Co. Ltd. as of 30 Jun 1953, leaving balance of surplus to be extended as consolidated surplus			
Share capital of R Co. Ltd. (30% of 1,000,000)		300,000	
Earned surplus R Co. Ltd. (30% of (250,000 + 120,000))		111,000	
Earned surplus S Co. Ltd. (30% of 80% of 90,000)		21,600	
Minority interest in R Co. Ltd.			432,600
To set up minority interest in R Co. Ltd. as of 30 Jun 1953, leaving balance of surplus in S Co. Ltd. to be extended as consolidated surplus.			
Sales		1,025,000	
Purchases			1,025,000
To eliminate inter-company sales			
Earned surplus (R Co. Ltd. — 70% of $7,000)		4,900	
Earned surplus (S Co. Ltd. — 56% of $4,000)		2,240	
Earned surplus (T Co. Ltd. — 100% of $1,700)		1,700	
Allowance for inter-company profits in inventory			8,840
To eliminate inter-company profit in inventory as of 30 Jun 1953. (Note: An elimination of the total profit of $12,700 is also correct.)			

Earned surplus of (S Co. Ltd. — 56% of (234,000 — 208,000))	14,560	
Consolidated profit and loss		1,456
Allowance for inter-company profit on sale of fixed assets		13,104

To eliminate inter-company profit on sale of machinery 2 Feb 1953.

(Note: An elimination of the total profit on the sale, i.e. $26,000, with an adjustment of profit of $2,600 is also correct.)

Examiner's Comments

Common difficulties of candidates were:

1. Some did not understand the need of eliminations for the minority interests.
2. A number of candidates did not know how to present the common shareholders' equity. Some split the reserves and surplus on the basis of common or preferred shareholdings over the total share issue.

PROBLEM 3

Final Examination, October 1953

Auditing I, Question 2 (18 marks)

(6 marks) (a) Discuss current accounting thought with respect to the use of the term "reserve" in financial statements.

(4 marks) (b) Should an adjustment affecting a prior year's operations be shown in the statement of profit and loss of the year in which it is determined or in the statement of surplus for that year? Discuss.

(4 marks) (c) What method of balance sheet presentation do you suggest for inventory reserves? Give your reasons.

(4 marks) (d) How would you recommend that a reduction in tax liability arising from the application of the loss carry-over provisions of the Income Tax Act be presented in the financial statements?

A SOLUTION

(a) Current accounting thought with respect to the term "reserve" in financial statements

The term "reserve" has been used in a number of widely different senses which tend to lead to a misunderstanding of financial statements. Many accountants now approve a restriction of the use of the term so that it will designate only amounts which have been appropriated from net profits or other surplus either (i) at the discretion of management or (ii) pursuant to the requirements of a statute, the instrument of incorporation, the by-laws of the company, or a trust indenture or other agreement. Following this reasoning the term "reserve" would no longer be used to designate amounts required to meet a liability or contingency known or admitted, or a decline in value which has already occurred as at the statement date.

Examples of reserves created at the discretion of management by an appropriation of profits are "general reserve", "general contingency reserve", "reserve for possible future decline in inventory values", and "reserve for future plant extensions". An example of a reserve created pursuant to a trust indenture or other agreement is a "bond redemption reserve".

Reserves of this kind should be shown in the shareholders' equity section of the balance sheet; and all changes in the amount of the reserves should be made through surplus.

(b) The treatment of an adjustment affecting a prior year's operations

If the amount of the adjustment is such that it will not distort the results of the current year's operations, most accountants would prefer to include it in the calculation of the current year's profit or loss. The adjustment should be set out as a separate item in the income statement unless it is so insignificant that a segregation would be ridiculous

If the amount of the adjustment is of such a size and nature that it would distort the picture of the current year's operations or mislead in any way if included in the calculation of the current year's income, then it should be treated as an adjustment of the surplus (retained earnings) account, or set out separately *after* the net profit figure in the income statement.

(c) The balance sheet presentation of inventory reserves

The treatment depends upon the *purpose* for which the reserve was created. If the "reserve" was set up to reduce the dollar amount of the inventory to its realizable value, then it should be deducted from the inventory figure on the balance sheet. (As indicated in part (a) above, however, the term "reserve" should not be used to describe an allowance or provision of this kind.)

If the purpose of the reserve is to provide for a future decline in inventory values, then it is merely a segregation of retained earnings. Such a reserve should be shown as part of the shareholders' equity, with a description of its nature.

(d) The treatment of a reduction in tax liability arising from the application of the loss carry-over provisions of the Income Tax Act

If the operations for the year have resulted in a profit which, for taxation purposes, may be offset in whole or in part by losses of previous years, the income statement should show the amount of the tax reduction resulting from carrying forward losses sustained in previous years.

If the operations for the year have resulted in a loss which, for taxation purposes, may be carried back in whole or in part to offset the taxable profit of the prior year, either the income statement or the surplus statement should show the amount of the reduction in taxes of the prior year attributable to the loss.

If the effect of these provisions has resulted in the creation of a claim for a refund of taxes already paid, the amount of the claim should be included among the current assets and, if material, shown as a separate item.

THE TAX REVIEW

Melville Pierce, B.A., LL.B., Editor

[1954] NOVEMBER Part 2

RECENT TAX CASES

Sellers-Gough Fur Co. v. M.N.R.

(*Exchequer Court of Canada, Cameron J., September 9, 1954*)

Business Profits — Damaged or Obsolete Stock — Inventory Valuation — Lower of cost or market value — "Market value" — Meaning of — Replacement cost or realizable value less normal profit — Anticipated future decline in value — Not to be considered — IWTA (1946)

Appeal — Appeal from ITAB to Exchequer Court — Trial de novo — Onus

At the close of its 1946 fiscal year on January 31, 1946 appellant company, a retail furrier, valued its inventory of merchandise at $108,631, which was some $35,500 less than its cost, but the Minister, in assessing appellant, valued it at $8,500 less than cost, thereby increasing the appellant's taxable income by some $27,000. Appellant appealed to the ITAB which allowed its appeal in part, and it then appealed to the Exchequer Court of Canada and the Minister cross-appealed. It was not disputed that the merchandise in question which had been in stock for some months and become shopworn had to some degree lessened in value, and it also appeared that a reduction in the excise tax on furs from 25% to 10% in December 1945 would have to be passed on to purchasers in the form of a reduction in price, and further that the fur coats in the inventory, which had been manufactured under wartime restrictions affecting style, would be at a competitive disadvantage with new coats manufactured after the withdrawal of the restrictions in the fall of 1945. These last two factors were not taken into consideration by the Minister in valuing the coats.

Appellant's valuation of the merchandise was made by its president upon personal inspection of each item, and he stated in evidence that he valued the inventory at its replacement value, taking into consideration the likelihood that the coats would not be sold for a period of several months and that the sales prices would have to be reduced from time to time, and that he endeavoured to value the inventory at a sum that would result in appellant making its normal gross profit. Evidence was given for appellant by an accountant that it was acceptable accounting practice in valuing obsolete goods for inventory purposes to take into consideration the length of time it would require to dispose of the goods, the conditions existing at such time, and their probable realization value, and that

it was customary accounting usage to take the lower of replacement cost or the amount determined as above described as "market value" in determining the lower of cost or market value, but not a combination of both. Notwithstanding the reduced valuation so placed by appellant on its coats on January 31, 1946 the selling prices of the coats remained at their mark-up of 50% to 60% over original cost in February, 1946, and in that month some of those coats valued at $19,976 were sold at a gross profit of $16,991, or a mark-up of 85% of their valuation.

Held, the appeal must be allowed. In ascertaining the profits of a commercial concern under the *IWTA,* it is necessary, in accordance with commercial accounting principles, to take into account the value of the stock-in-trade at the beginning and at the end of the taxation period and to enter its value at the close of that period at cost or market value, whichever is lower. While the value to be placed upon stock-in-trade at a particular time is entirely a question of fact, here the valuations of both appellant and Minister were wrong, the Minister's being too high because certain factors were ignored and the appellant's being too low because estimated future reductions in the sales prices of the coats were taken into consideration: that was in effect setting up an inventory reserve. "It is of paramount importance to keep in mind that the object of the computation in which the closing inventory values constitute one element is to determine as precisely as possible the actual balance of the profits and gains in each year of the company's operations; and that only those elements of loss or expense enter into the computation which are suffered or incurred during the taxation year in question." *Collins & Sons Ltd.* v. *C.I.R.,* 12 T.C. per Clyde L.P. at pp. 780, 783 approved. Even though it might be in accordance with accepted accounting usage to take future inventory losses into account when valuing inventory they could not be taken into account in ascertaining profits of a taxation year under the *IWTA.*

It was therefore necessary for the Court to determine from the evidence what should have been established as the fair market value. The evidence did not make it possible to ascertain the replacement market value, but the market value taken as the realizable value less the normal profit could be ascertained from the relationship of the sales prices received in February 1946 for goods listed in the 1946 closing inventory to the valuation of those goods in the said inventory; applying that relationship to the whole of the 1946 closing inventory its value should be fixed at $120,199, and the appeal of appellant must therefore be allowed and the cross-appeal dismissed.

Held, also, an appeal to the Exchequer Court from a decision of the ITAB is a trial *de novo* of the issues of fact and law, and proceeds without regard to the case made before the Board or the Board's decision; and whether the appeal be by the taxpayer or the Minister the assessment carries with it a presumption of validity until the taxpayer establishes that it is incorrect in fact or in law. *MNR* v. *Simpson's Ltd.* [1953] Ex. C.R. 93, followed.

Appeal allowed

INCOME TAX APPEAL BOARD CASES

Fabio Monet, Esq., Q.C. (Chairman), Cecil L. Snyder, Esq., Q.C. (Assistant Chairman), W. S. Fisher, Esq., Q.C. and R. S. W. Fordham, Esq., Q.C.

175 v. M.N.R.

Income or Capital Gain — Companies — Company holding mineral rights over vast acreage — Grant of options to buy petroleum — Intention of vendor and its controlling shareholder — Objects clause of company — Effect of — IWTA (1946) s. 3

In 1943 O purchased the mineral rights in a vast acreage in Alberta from a company which desired to sell to avoid the potential tax liabilities attached to the rights. O, together with his daughter, two sons, two professional partners, his secretary and a geologist took title to the property, the consideration being small, and caused the incorporation of two companies, one to hold the mineral rights in fee and the other (appellant company) to hold long term leases of the rights, O being the controlling shareholder in both companies. During the three years following the incorporation of appellant a considerable time was spent in exploring the property, cataloguing minerals, searching titles, preparing plans, etc. There were four leases in force at the time of the purchase, two of which were cancelled or allowed to lapse and two extended. One lease was granted to the geologist who proceeded to drill for oil but was unsuccessful, and a further lease was granted to Imperial Oil Co. on three quarter-sections, and some leases of gravel pits or sales of gravel were made, but the company did not itself undertake any operations for the development of the property. In May 1946 appellant granted an option to Shell Oil Co. of Canada, exercisable within 1946 or 1947, to purchase petroleum and natural gas and related hydrocarbons other than coal in some 300,000 acres for a price ranging from $20 to $5 per acre plus a royalty (ranging from 2½% to 6½%) of any oil produced from the said land. Appellant received $30,000 on granting the option, which amount was to be applied to the purchase-price if the option was exercised, but the option was not exercised, and in 1946 appellant carried the said sum into its capital surplus. In 1947 appellant granted a similar option to Imperial Oil Co., for which it received $250,000 in that year, and that option also was not exercised. Appellant company was assessed to tax in respect of the two amounts above-mentioned for 1946 and 1947 respectively on the ground that they were profits or gains from a business or other source within the meaning of IWTA s. 3. Appellant appealed, contending that it was not in the business of dealing in options, that the company's intention in acquiring the property was to develop it and not to turn it over at a profit, that although the objects clause in its memorandum of association included, *inter alia,* the leasing, selling, and dealing with its properties, the company did not in fact carry on the business of leasing and dealing in its property and that the profit made was an accretion to capital. At the hearing of the appeal O, the controlling shareholder, and his professional partner, a minority shareholder, gave evidence as to the personal intentions of O at the time he acquired the property and the intention of the directors thereafter, to the effect that the company intended to develop the property itself and granted the options in issue not for the profit to be made from the initial payment but to encourage the optionees to proceed with the development of the land.

Held (per Messrs Monet and Fisher, Mr. Fordham dissenting), the two amounts were assessable to tax.

Per Mr. Fisher: The objects clause of this closely-held company expressly stated that selling and dealing with its property was one of the company's objects, and inasmuch as the Companies Act of the Province under which appellant was incorporated expressly conferred that incidental and ancillary power on all companies, appellant must by explicitly taking the power be held to have been carrying on the business of dealing in its property when it granted the options in question: *Sutton Lbr. Co.* v. *MNR* [1954] 1 Tax Rev. 133 (Sup. Ct. of Can.) discussed.
Per Mr. Monet: The appeal should be dismissed.

Per Mr. Fordham (dissenting): The oral evidence did not support a finding that appellant contemplated the sale of the greater part of its capital assets for whatever it could get but rather that it granted the two options in order to bring about the development of the land with a view to obtaining royalties from the oil produced. The governing factor is not what business the company proposed to conduct but what business it actually did conduct. *Sutton Lbr. Co.* v. *M.N.R., supra,* applied. Moreover, as neither of the options were exercised no sale of anything actually took place.

June 7/54 *Dismissed*

C.W. Logging Co. v. M.N.R.

Income or Capital Gain — Companies — Logging company — Memorandum of association — Objects clause — Explicit assumption of power accorded by statute — Sale of timber and timber lands by logging company

Appellant company was incorporated under the B.C. Companies Act in 1934 by registration of its memorandum of association, which set forth the company's objects as being to carry on business as timber-owners, mill operators, loggers, and also to turn to account, sell, and deal in timber and timber lands, etc. etc. The company's operations from its formation were limited to straight logging, though in 1943 it sold some timber lands after logging them. In 1950 it sold the standing timber on a previously logged tract to a firm of small operators who could log the remaining timber thereon at a profit, which appellant, because of its greater size, could not do, appellant's object being to get rid of the older standing timber, which constituted a fire hazard to other timber held by it. In 1952 it sold the said timber lands to the same firm. It was assessed to income tax in respect of the sums received by it in 1950 and 1952 on the sale of the timber and the timber lands respectively.

Held (Mr. Fisher), the company was assessable to tax on the amounts in question. When the company explicitly assumed the power to deal in timber and timber lands in its memorandum of association, powers which it would have in any event under the B.C. Companies Act as ancillary to its main objects, it must be concluded that in selling the timber and the timber lands it was doing what it was incorporated to do and therefore that the amounts received were of an income nature. *175* v. *MNR, supra,* followed. *Anderson Logging Co.* v. *The King* [1925] S.C.R. at p. 56, discussed.

B.C., Jun 8/54 *Dismissed*

Ardwold Gate Ltd. v. M.N.R.

Income or Capital Gain — Company acquired to realize building land — Intention merely to protect incorporators' investment in homes — No business carried on

Some dozen acres of high-class residential land in Toronto, held by a company, were subdivided and subjected to rigorous building restrictions and placed

on sale as building lots, of which four were sold and houses built thereon prior to the war. In 1949, no further houses having been built in the interval, a speculative builder offered to buy the remaining lots with a view to erecting cheaper houses thereon when the building restrictions expired. The owner, considering itself morally obligated to give the previous purchasers the first refusal, offered them the land, and they bought it for $54,000 solely with a view to preventing the erection of cheaper houses thereon, which would adversely affect the value of their homes. The four purchasers procured the incorporation of appellant company under the Ontario Companies Act to take title to the lands, in the view that sales could be made more conveniently by the company than by the four incorporators. Each of the four subscribed $6,400 to the company's capital. The company's letters patent set out its object as being to purchase the specific land referred to and incidental objects, and it purchased no other land. The land was made subject to even more severe building restrictions, careful and unusual arrangements were made for its sale through a real estate agent, and in fact several offers to purchase lots were refused because the purchasers were not prepared to erect a house in keeping with those already there. During 1949, 1950 and 1951 the company sold all but one lot, retaining that one in order to be in a position to enforce the building restrictions; it refused an offer of $7,500 for that lot in 1953. The company's gains from the sale of the lots were $3,725.87 in 1949, $12,282.57 in 1950, and $6,589.36 in 1951. It was assessed to income tax in respect of these gains, and appealed, contending that its charter was obtained not for the purpose of carrying on a real estate business, but merely to facilitate the liquidation of the land in question, and that in fact no business was actually carried on.

Held (Mr. Fordham), on the evidence it must be found that no business was carried on; appellant company was simply seeking to liquidate real estate that had long proved difficult to dispose of satisfactorily: *Salisbury House Estate Ltd.* v. *Fry* (1930) 15 T.C. 266, per Lord Warrington of Clyffe at p. 316, applied. In view of the evidence as to the business actually carried on by appellant company it was unnecessary to have recourse to the company's charter: *Sutton Lbr. Co.* v. *MNR* [1953] 2 S.C.R. 77, applied; *C.W. Logging Co.* v. *MNR, supra*, distinguished.

Ont, Jul 5/54 *Allowed*

McMahon & Burns Ltd. v. M.N.R.

Income or Capital Gain — Companies — Investment Dealer — Purchase and sale of bonds on own account — Whether part of regular business — Whether investment

Appellant was incorporated under the B.C. Companies Act in 1939 and since then carried on business as an underwriter and investment dealer in government, municipal and commercial securities and, to a lesser extent, as a stockbroker. In September 1949 it was a member of a group of investment dealers formed to underwrite the sale to the public of $17,000,000 of 4% convertible debentures of the Interprovincial Pipe Line Co. At about the same time it purchased on its own account debentures of this issue to the face amount of $100,000, and recorded the purchase in its investment account. The debentures were bought for $91,500, of which appellant borrowed $36,500 from a bank, the debentures being put up as collateral. In July, 1950 owing to threatening world conditions appellant sold debentures to the face amount of $40,500 at a profit of $56,038 and in December it sold debentures to the face amount of $5,000

at a profit of $8,737.50, the total profit being recorded in its books as a capital surplus. Appellant was assessed to income tax on the gain so made, and appealed, contending that it acquired the debentures not in the ordinary course of its business but as a private investment.

Held (Mr. Fordham), the transaction in question was of a kind so closely identified with and akin to the company's regular business that it must be regarded as part of it. Moreover the bonds were held for a relatively short period of time, and it was difficult to resist the inference that the appellant did not, in the course of its business, perceive the possibility of making a substantial profit within a short time and took advantage of it. In view of the ample evidence of the nature of appellant's business it was unnecessary to look at its memorandum of association to determine its effect: *Anderson Logging Co.* v. *The King* [1925] S.C.R. 45 distinguished; *Gairdner Securities Ltd.* v. *MNR* [1954] S.C.R. applied.

B.C. Aug 9/54 *Dismissed*

Pawluk v. M.N.R.

Income or Capital Gain — Sale of top soil of farm by farmer — Realization of capital asset

Pawluk owned and operated a farm of 88 acres near Edmonton and another farm of 161 acres not far away. A large industrial plant and three oil refineries were erected in the immediate neighbourhood of his 88 acre farm and in 1951 the municipality commenced to construct a roadway across the farm. At Pawluk's request the road construction was temporarily suspended to permit him to strip the valuable topsoil from the route of the roadway, and he and his hired man removed the topsoil therefrom, about 5 acres in all, and from an additional 5 acres. Pawluk advertised it for sale in an Edmonton newspaper and his son delivered it to customers. In 1951 he sold about 1,200 loads of topsoil in the Edmonton district. While doing this Pawluk continued his farm operations. He was assessed to income tax in respect of his proceeds from the sale of topsoil in 1951, *viz.*, $12,743, and appealed.

Held (Messrs. Snyder and Fisher), on the evidence it must be found that he was merely realizing a capital asset and not carrying on a business or an adventure or concern in the nature of trade.

Alta, Aug 13/54 *Allowed*

Sanders v. M.N.R.

Business — Chicken hatchery business — Compensation received from loss of pedigreed flock — Whether trading stock or capital asset — Trader not bound by entries in accounts

Sanders went into the chicken hatchery business in 1943, and in 1945 purchased equipment together with a certified flock of pedigreed chickens and certain other hens and poultry stock. The certified stock and other poultry were all shown in his books of account as "inventory on hand". Subsequently he and a partner caused the incorporation of a company to raise chickens for sale as table poultry and also eggs for sale, but Sanders retained ownership of the pedigreed flock though lending it to the company on the understanding that it would maintain the original standard both as to quality and numbers. The pedigreed flock was maintained for the raising of pedigreed eggs and chicks for sale to commercial hatcheries and not primarily for the sale of the fowl, though from time to time the older fowl would be removed and replaced by younger ones, the older birds being disposed of as table poultry. In 1950 a disease struck in the locality and the Government caused the pedigreed flock to be destroyed, and Sanders was paid $11,248 in compensation for their loss. The Minister included this

sum as a trading receipt in assessing Sanders to tax for 1950.

Held (Mr. Fisher), a taxpayer is not bound for tax purposes by the way in which he keeps his accounts, and though Sanders described the pedigreed stock in his accounts as inventory the fact was that he did not purchase the pedigreed stock for resale as table poultry but to hold it as a continuing asset from which he would obtain more pedigreed stock and eggs for sale in the hatchery business, and the pedigreed stock was therefore a capital asset and the compensation received for its destruction was a capital receipt and not subject to income tax. *Sterling Trust Ltd.* v. *C.I.R.*, 12 T.C. 868, per Pollock M.R. at p. 882; Atkin L.J. at p. 888, applied. *British Insulated & Helsby Cables Ltd.* v. *Anderton* [1926] A.C. 205, per Cave L.C. at p. 213, applied.

B.C., Mar 31/54 *Allowed*

Gulf Securities Co. v. M.N.R.

Companies — Profit-making company— Ordinary business making of loans — Single speculation in shares — Loss sustained on fall in market price — Whether trading loss or capital loss

In 1946 a group of young men caused the incorporation of appellant company and agreed to subscribe $10 a month each to provide working capital to further the objects of the company which included the purchase and sale of bonds, stocks and other securities, their object being the production of income. In the first two or three years of the company's operation its funds were used for making loans on chattel mortgages and conditional bills of sale, and the like, in order to acquire experience in this class of investment and determine which type of loan was most advantageous for the shareholders of the company. In June 1950 the company purchased 1,000 shares of a certain mining company's stock for $3,200 in the belief that it would make a profit on a rise in the market price of the shares, it being recognized that the shares, upon which no dividend had been paid for a number of years, were not a dividend-paying investment. The market price of the shares fell, however, and in November, 1950 the company disposed of them for $1,876, sustaining a loss of $1,324, which it claimed to be a trading loss for tax purposes notwithstanding that the shares had been shown on the company's balance sheet for its fiscal period ending September 30, 1950 under the heading "Investments". The Minister, in the view that the loss sustained was a capital loss, refused to allow the deduction of the loss in assessing appellant for 1951. Appellant appealed.

Held (Mr. Fisher), it must be found that the shares were purchased not as an investment of the company's funds but in the ordinary course of business and with the intention of making a taxable profit thereon by resale if there was a rise in the value of the shares on the stock market, and accordingly the loss sustained was a trading loss and deductible in determining the company's income for 1951.

B.C., Apr 8/54 *Allowed*

170 v. M.N.R.

Companies — Capital gain or trading profit — Lumber company taking shares in land company in settlement of debt — Subsequent sale of land

The president of appellant company held all the outstanding shares of a land company which owned a large tract of land that had been subdivided into lots by a previous owner. Efforts to sell the property were unsuccessful, and it was evident that the lots could not be sold unless water, roads, and grading were put in at considerable expense. The president of appellant company did not have

the necessary capital and was unable to obtain it from real estate developers. At the end of 1943 the president of appellant company was insolvent, and was personally indebted to appellant company in the amount of $26,451 for advances made. Appellant company's directors wished to settle the debt, and on December 31, 1943 an agreement was reached whereby appellant's president transferred to appellant all his shares in the land company, and covenanted that if the amount ultimately realized by the company on the shares was less than the amount of his debt he would make the deficiency good. In 1944 appellant had the land company wound up and thereafter held title to the land itself. Appellant tried without success to sell the land in one parcel until 1948 and during that time consistently rejected offers to buy individual lots or small blocs. Finally in December 1948 it made an agreement with a real estate agent to sell the 340 lots into which the land was subdivided, arranged with the municipality to put in a water system at appellant's cost (amounting in all to some $63,500), did some grading and put in some roads. The real estate agent disposed of the lots during 1949, 1950, and 1951, and appellant was assessed to tax on the profit made on their sale, which was considerable.

Held (Messrs. Monet and Snyder), although it may have been appellant's original intention in acquiring the shares in the land company merely to recover a debt due it and not to sell the land as part of a scheme for profit-making, it subsequently abandoned its original purported intention and entered into and engaged in the operation of a business or activity or an adventure in the nature of trade for the purpose of making a profit, and the profit was taxable as income under the Income Tax Act.

Apr 14/54 *Dismissed*

172 v. M.N.R.

Purchase and sale of building lots — Isolated transaction — Surrounding circumstances — Whole course of conduct — Intention — Whether profit capital gain or income

Appellant, a wholesale meat dealer, purchased 78 vacant building lots at $1,000 each at the suggestion of a lifelong friend who was manager of a home-building company, and less than two months later sold the lots at $1,500 each to a person introduced by the above-mentioned friend. The lots were located in an area where the building of homes was at a peak at the time of their purchase, and at the time that he bought them it was not appellant's intention of renting any or all of them or farming them or building on them.

Held, (Mr Monet), having regard to the facts that the lots were purchased at a time and in a place where home building was at a peak, that appellant's friend who advised him to buy and then sell was in the house-building business and aware of the great demand for vacant lots by home building contractors, and that appellant held the lots for a very short time, it must be concluded from appellant's whole course of conduct that in buying and selling the lots he was engaged in carrying on a business or activity or an adventure or concern in the nature of trade for the obvious purpose of making a profit, and that such profit was income.

Ont, May 3/54 *Dismissed*

Fortier v. M.N.R.

Recapture of Capital Cost Allowances—Election to spread amount recaptured over income of prior years — Not a reopening of prior years' assessments — ITA 1948 s. 20(1), 39A(1)

In 1951 appellant sold a building in respect of which he had deducted a total

of $513 capital cost allowances in 1949 and 1950, and in 1951 he was assessed to tax in respect of this sum under ITA 1948 s. 20(1) as recaptured capital cost allowances. In assessing appellant the Minister applied s. 39A as if appellant had elected to be assessed thereunder, i.e., the recaptured capital cost allowances were apportioned equally over the appellant's incomes for 1949, 1950 and 1951 and tax assessed accordingly. On receipt of the notice of assessment for 1951 appellant filed with the Minister receipts for charitable donations of $90 and $215 made by him in 1949 and 1950 respectively and claimed these amounts as deductions from his income for those years.

Held (Mr. Monet), an assessment made pursuant to s. 39A does not have the effect of reopening the assessments for the preceding years to which the section refers; it simply indicates the manner in which the tax for the year under assessment shall be computed.

Que, May 12/54 *Dismissed*

Tercier v. M.N.R.

Income — Nature of — Guarantee of loan to company — Remuneration to directors for furnishing — Income

Tercier, an implement dealer, and a number of other residents of Bonnyville, Alberta formed a syndicate for the purpose of drilling gas wells in that area and supplying gas to Bonnyville, and in 1949 they procured the incorporation of a private company to take over the business of the syndicate, exchanging their interests in the syndicate for shares in the company. In 1950 the company required funds and ten of its shareholders jointly and severally agreed to guarantee a bank loan of $50,000 to the company. For doing so each of them was allotted 500 common shares in the company. Five of these shareholders, Tercier among them, were directors of the company, and each of the five was assessed to income tax for 1950 on the value of the shares so received. They appealed.

Held (Messrs. Fisher and Snyder), the appeal must be dismissed. *Ryall* v. *Hoare* [1923] 2 K.B. 447, 8 Tax Cas. 521, followed.

Alta, Jul 22/54 *Dismissed*

Baynes v. M.N.R.

Gift Tax — Settlement of property on trustees in trust for infant children — Not a gift to trustees — Exempt from gift tax — ITA s. 58, 101(3)

In 1951 Baynes made a gift to his wife of property to the value of $8,250 and in the same year settled two shares of stock valued at $4,000 on his wife and one M as trustees to hold the stock until each of Baynes' four children attained the age of 21, on the attaining of which each child would become entitled to one-half of a one-third interest in the said shares and on attaining the age of 25 to the other half. In 1951 all the children were under 16 years of age. Baynes was assessed to gift tax on the value of the shares so settled in trust on the ground that the settlement was a gift not to the settlor's children but to the trustees, and that the trustees constituted one individual within the meaning of the Income Tax Act. Baynes appealed, contending that ITA s. 101(3) applied to exempt the gift from taxation. Section 101(3) provides:

> Where the value of all gifts made by a donor to an individual in a taxation year does not exceed $1,000, those gifts are exempt from tax . . . . .

Held (Mr. Fordham), the settlement of the property on the trustees in trust for the settlor's children was not a gift of the property to the trustees. Moreover, section 58 of the Act, which declares that a trust shall be deemed to be an individual in respect of the trust property, has no relevance to gift tax.

B.C., Jul 23/54 *Allowed*

THE INCOME TAX REGULATIONS

PARTS XII AND XIII AMENDED

P.C. 1954-1294, September 1, 1954

HIS EXCELLENCY the Governor General in Council, on the recommendation of the Minister of National Revenue and by virtue of the powers conferred by section 117 of the Income Tax Act, is pleased to amend the Income Tax Regulations made and established by Order in Council P.C. 6471 of 22nd December, 1949, as amended, and the said regulations are hereby further amended in accordance with the Schedule hereto, the said amendments to be applicable to the 1953 and subsequent taxation years.

SOR/54-401 *Canada Gazette, Sep 22/54*

SCHEDULE OF AMENDMENTS

1. By revoking Part XII thereof and by substituting therefor the following new Part XII:

PART XII

Deductions in Respect of Oil Wells, Gas Wells and Certain Mines

1200. For the purpose of pararaph (*b*) of subsection (1) of section 11 of the Act there may be deducted in computing the income of a taxpayer for a taxation year amounts determined as hereinafter set forth in this Part.

Deductions Allowed to Operators

1201. **(1)** Where the taxpayer operates

(*a*) an oil or gas well,

(*b*) a precious metal mine,

(*c*) a base metal mine,

(*d*) an industrial mineral mine in respect of which the Minister of Mines and Technical Surveys has certified that the mineral is contained in a non-bedded deposit or that the mineral is sylvite, or

(*e*) more than one of such wells or mines, the deduction allowed is 33 1/3 per cent of the aggregate of the profits minus the aggregate of the losses of the taxpayer, for the taxation year, reasonably attributable to the production of oil, gas, prime metal and industrial mineral from such wells and mines.

(2) Where the value of the output of gold from a mine operated by a taxpayer in a taxation year is not less than 70 per cent of the aggregate value of the output of the wells and mines, of the classes described in subsection (1), operated by the taxpayer in the year, in lieu of the deduction otherwise allowed under subsection (1), the deduction allowed is the greater of

(*a*) 40% of the aggregate of the profits minus the aggregate of the losses of the taxpayer, for the taxation year, reasonably attributable to the production of oil, gas, prime metal and industrial mineral from the wells and mines, or

(*b*) \$4.00 per ounce of the output of gold for the year.

(3) In computing the profits reasonably attributable to the production of oil, gas, prime metals and industrial minerals for the purpose of this section, a deduction shall be made equal to the aggregate of the amounts, if any, deducted in computing the taxpayer's income for the taxation year under the provisions of subsection (10) of section 141 of the Act and sections 1204 and 1205 of these Regulations.

(4) For the purpose of this section,

(*a*) "industrial mineral mine" does not include a coal mine;

(*b*) "profits reasonably attributable to the production of prime metal or industrial mineral" do not include profits that are not included in computing the taxpayer's income for the taxation year;

(*c*) output for a taxation year from a mine does not include output for a period in respect of which the profits therefrom are not included in computing the taxpayer's income; and

(*d*) where someone other than the taxpayer has an interest in the proceeds from the sale of the products of a well or mine operated by the taxpayer, the value of

the output for a taxation year from a well or mine is only that portion of the total value of the output from the well or mine that can reasonably be regarded as the proportionate share thereof that was included in computing the taxpayer's income.

(5) For the purpose of this Part, a taxpayer who has an interest in the proceeds of production from an oil or gas well or a mine under an agreement which provides that he shall share in the profits remaining after deducting the costs of operating the well or mine, shall be deemed to be a person who operates the well or mine.

Deductions Allowed to Non-Operators

1202. (1) Where a person other than the operator

(*a*) has an interest in the proceeds from the sale of the products of an oil well, gas well or a mine of a class described in subsection (1) of section 1201, or

(*b*) receives a rental or royalty computed by reference to the amount or value of the production from such a well or mine,

the deduction allowed is 25 per cent of the amount in respect of the interest, rental or royalty included in computing his income for the year.

(2) Where the amount received in respect of an interest in the income from a well or mine is a dividend or is deemed to be a dividend, subsection (1) does not apply.

Coal Mines

1203. The deduction allowed for a taxation year in respect of a coal mine operated by a taxpayer is 10 cents for each ton of coal mined in the year.

Additional Allowances to Certain Oil and Gas Wells

1204. (1) Where a taxpayer has income for a taxation year from an oil or gas well that is outside of Canada, in computing his income for the year he may deduct the lesser of

(*a*) the aggregate of drilling costs incurred by him in that year and previous taxation years in respect of the well (not including the cost of land, leases or other rights and not including indirect expenses such as general exploration, geological and geophysical expenses) minus the aggregate of all amounts deductible in respect thereof in computing his income in a previous year, or

(*b*) that part of his income for the year that may reasonably be regarded as income from the well.

(2) Where an individual has income for a taxation year from an oil or gas well in Canada, in computing his income for the year he may deduct the lesser of

(*a*) the aggregate of drilling costs incurred by him in that year and previous taxation years in respect of the well (not including the cost of the land, leases or other rights and not including indirect expenses such as general exploration, geological and geophysical expenses) minus the aggregate of all amounts deductible in respect thereof in computing his income in a previous year, or

(*b*) that part of his income for the year that may reasonably be regarded as income from the well.

(3) If a taxpayer has more than one oil or gas well to which subsections (1) or (2) may apply, the allowance in respect of the drilling costs of each well shall be computed separately.

Additional Allowances to Certain Mines

1205. (1) Subject to subsection (3), where a taxpayer operates in Canada a coal mine or a mine described in subsection (1) of section 1201, he may deduct, in computing his income for a taxation year, such amount as he may claim not exceeding 25 per cent of an amount calculated as set forth in subsection (2).

(2) The amount referred to in subsection (1) is the aggregate of all expenditures made or incurred by the taxpayer which are reasonably attributable to the prospecting and exploration for and the development of the mine, prior to the mine coming into production in reasonable commercial quantities, minus the aggregate of

(*a*) such expenditures in respect of which a deduction from, or in computing, a taxpayer's income tax or excess profits tax was provided by section 8 of the Income War Tax Act;

(*b*) amounts in respect of such expenditures

deducted in computing a taxpayer's income under section 16 of chapter 63 of the Statutes of 1947 or section 16 of chapter 53 of the Statutes of 1947-48 or, if the expenditure was incurred prior to 1953, under section 53 of chapter 25 of the Statutes of 1949, Second Session;

(*c*) such expenditures incurred after 1952 in respect of which a deduction was or is provided by section 53 of chapter 25 of the Statutes of 1949, Second Session;

(*d*) such expenditures that were deducted in computing the income of the taxpayer in the year made;

(*e*) the cost of properties in respect of which an allowance is provided under paragraph (*a*) of subsection (1) of section 11 of the Act; and

(*f*) the cost of a leasehold interest.

(3) The amount deductible under subsection (1) shall not exceed the amount determined under subsection (2) minus the aggregate of

(*a*) amounts deducted under subsection (1) in computing the income of the taxpayer for previous taxation years, and

(*b*) similar amounts deducted in computing the income of the taxpayer for the purposes of the Income War Tax Act and the 1948 Income Tax Act.

2. By revoking section 1303 thereof and by substituting therefor the following new section 1303:

1303. For the purposes of this Part,

(*a*) "mineral profits" means the aggregate of

(i) the profits of the corporation reasonably attributable to the production of oil, gas, prime metal and industrial mineral as determined for the purpose of section 1201,

(ii) those amounts in respect of which the corporation is allowed a deduction in computing income by virtue of section 1202,

(iii) those profits of the corporation which are not included under (i) by reason of paragraph (*b*) of subsection (4) of section 1201, and

(iv) dividends received by the corporation in respect of which a deduction is allowed under paragraph (*c*) of section 1300,

minus

(v) the aggregate of losses of the corporation reasonably attributable to the production of oil, gas, prime metal and industrial mineral as determined for the purpose of section 1201,

for the taxation year ending in the calendar year immediately preceding the calendar year in which the dividend was declared by the corporation;

(*b*) "income" means the income of the corporation for the taxation year ending in the calendar year immediately preceding the calendar year in which the dividend was declared before any deduction is made under the provisions of paragraph (*b*) of subsection (1) of section 11 of the Act or under the provisions of subsection (2) of that section, plus an amount not included in computing the income of the corporation by reason of the provisions of subsection (5) of section 83 of the Act.